



UNITED STATES OF AMERICA  
BEFORE THE FEDERAL TRADE COMMISSION

COMMISSIONERS: Jon Leibowitz, Chairman  
William E. Kovacic  
Edith Ramirez  
J. Thomas Rosch  
Julie Brill (recused)

In the Matter of )  
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THE NORTH CAROLINA [STATE] BOARD ) PUBLIC  
OF DENTAL EXAMINERS. ) DOCKET NO. 9343  
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**RESPONDENT’S MOTION TO DISQUALIFY THE COMMISSION**

Pursuant to 16 C.F.R. §§ 3.22(a), 3.42(g)(2) and 4.17, Respondent, the North Carolina State Board of Dental Examiners (“State Board”), hereby moves the Commission:

1. to disqualify and remove itself as the Administrative Law Judge (“ALJ”) and to appoint as the presiding official over the administrative hearing a duly-qualified ALJ who is not a Commissioner; and
2. to disqualify and remove itself as the adjudicator of the State Board’s Motion to Dismiss, and Complaint Counsel’s Motion for Partial Summary Decision, both filed on November 3, 2010 and currently pending in this matter.

In support of this Motion, Respondent submits that disqualification and removal is appropriate because:

1. the Commission lacks the legal authority to rule on the constitutionality of its exercise of jurisdiction over the State Board;

2. the Commission has prejudged its ability to exercise jurisdiction over the State Board, inasmuch as the Commission already has ruled that, as a matter of law, it has “reason to believe” the State Board has conspired to restrain trade based solely and merely upon the legal theory that a state licensing board comprised of a majority of licensees constitutes a *per se* conspiracy; and
3. the Commission already has determined as a matter of law, despite the undisputed fact that the State Board is a state agency, that the State Board must satisfy the second prong of the *Midcal* test to show state action doctrine immunity.

Each of these issues is a legal conclusion that was prejudged by the Commission when it determined that it had “reason to believe” that the State Board was subject to, and had violated, the FTC Act.

The FTC Rules of Practice provide that motions to disqualify are to be “supported by affidavits setting forth the alleged grounds for disqualification.” 16 C.F.R. § 3.42(g)(2); *see also* 16 C.F.R. § 4.17(b)(1). These Rules presuppose the need for third-party verification of the grounds for disqualification. However, with regard to the State Board’s first reason for disqualification, there are no underlying facts so no third-party verification is needed or available. Therefore, no affidavit is needed to establish the basis for disqualification. With regard to the State Board’s second and third reasons for disqualification, the documents indicating prejudgment and bias, which are attached hereto as Exhibits A-D, speak for themselves and do not require an affidavit. However, to the extent that certification of authenticity is required to establish that the documents are “correct and true,” such certification is attached as Exhibit E.



Respondent's Counsel has conferred with Complaint Counsel in a good-faith effort to resolve by agreement the issues raised by this motion and has been unable to reach such agreement. Further, Complaint Counsel has indicated their intention to oppose this motion.

## ARGUMENT

### **I. State Board Is Entitled to a Fair and Impartial Administrative Hearing.**

An administrative hearing "shall be presided over by a duly qualified Administrative Law Judge or by the Commission or one or more members of the Commission sitting as Administrative Law Judges . . . ." 16 C.F.R. § 3.42(a). The presiding ALJ "shall have the duty to conduct **fair and impartial hearings . . . .**" 16 C.F.R. § 3.42(c). Any party to an administrative proceeding may file a motion to disqualify and remove the presiding ALJ, upon deeming that grounds exist for such disqualification. 16 C.F.R. § 3.42(g)(2); *see* 16 C.F.R. § 4.17(b)(1).

As an initial matter, an administrative hearing "must be attended not only with every element of fairness but with the very appearance of compete fairness." *Amos Treat & Co., Inc. v. Securities and Exchange Comm'n*, 306 F.2d 260, 267 (D.C. Cir. 1962). "Fairness of course requires an absence of actual bias in the trial of cases." *Id.* at 263; *see generally* 5 U.S.C. § 556(b) (administrative proceedings "shall be conducted in an impartial manner.")

### **II. The Commission Lacks the Legal Authority to Rule on the Constitutionality of Its Exercise of Jurisdiction Over the State Board.**

The Commission is empowered with Congressionally-delegated authority "to prevent persons, partnerships, or corporations . . . from using unfair methods of competition in or affecting commerce and unfair or deceptive acts or practices in or

affecting commerce.” 15 U.S.C. § 45(a)(1). In the present case, however, two important jurisdictional questions must be answered before the Commission may determine whether the State Board has violated 15 U.S.C. § 45(a)(1): 1) whether the State Board is subject to the Commission’s jurisdiction; and 2) regardless of whether such jurisdiction indeed does exist, whether the Commission has the legal authority to rule on the constitutionality of its exercise of such jurisdiction over the State Board.

For purposes of this Motion, it is the latter question that is dispositive, and currently pending before the Commission in the State Board’s Motion to Dismiss and Complaint Counsel’s Motion for Partial Summary Decision. The answer may be gleaned from an examination of the legal authority provided to the Commission from Congress and from the States’ constitutionally-provided prerogatives. In light of Congress’ silence with regard to delegation of jurisdiction over the sovereign acts of the States to the Commission<sup>1</sup>—combined with the express reservation of non-delegated powers afforded to States by the Tenth Amendment—it is clear that the Commission lacks the legal authority to rule on the constitutionality of its own jurisdiction. Therefore, the Commission should disqualify and remove itself as the adjudicator of the State Board’s Motion to Dismiss and Complaint Counsel’s Motion for Partial Summary Decision.

The Commission may attempt to argue that the holding in *FTC v. Cement Inst.*, 333 U.S. 683 (1948) prevents the State Board from raising these jurisdictional concerns. However, *FTC v. Cement Inst.* is inapposite. In that case, the U.S. Supreme Court held that the Commission had the jurisdiction “to entertain the complaint and to act on it” because the Commission acted appropriately in interpreting the FTC Act to include

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<sup>1</sup> See *Parker v. Brown*, 317 U.S. 341 (1943). The State Board hereby incorporates by reference its arguments with regard to its immunity from the application of the Federal Trade Commission Act (“FTC Act”).



certain restraints of trade made unlawful by the Sherman Act. In so finding, the Court noted that FTC Act's "legislative history shows a strong congressional purpose" consistent with the Commission's enforcement efforts. *Id.* at 690-93. In contrast, the present case requires the Commission to consider its own jurisdiction over issues of constitutional laws, in the absence of implied or express Congressional authority and in light of the Tenth Amendment and the limits on the Commerce Clause.

Furthermore, to the extent that the Commission attempts to argue that the "rule of necessity"<sup>2</sup> requires that this proceeding be heard before the Commission, such argument is unpersuasive. Particularly, the Commission is faced with several options; it may appoint another ALJ who is outside of the Commission, pursuant to 16 C.F.R. § 3.42(a) and (g) to proceed over the administrative hearing in this matter, and it may allow the currently-pending motions on the issue of state action doctrine to proceed directly to district court because further administrative review of this issue would be futile. *See Honig v. Doe*, 484 U.S. 305, 326-27 (1988).

### **III. The Commission Has Prejudged Its Ability to Exercise Jurisdiction Over the State Board.**

In numerous publications and speaking engagements over the past decade, the Commission has articulated its express intent to exercise jurisdiction over entities engaging in activities that have been deemed "state action" by federal courts. For instance, in its 2003 Report of the State Action Task Force, the Commission Task Force recommends "clarification and re-affirmation" of its own interpretation of the state action doctrine, in light of its opinion that federal courts "have applied the [state action] doctrine

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<sup>2</sup> The rule of necessity provides that a judge will not be disqualified from trying a case if there is no other adjudicator available to hear and decide the case. *Atkins v. U.S.*, 556 F.2d 1028, *cert. denied*, 434 U.S. 1009 (1978).

in a manner that could potentially endanger national competition goals.” Federal Trade Commission, Report of the State Action Task Force, p. 1 (Sept. 2003) (hereinafter “Task Force Report”)<sup>3</sup> (Exhibit A). In order to achieve such “clarification and re-affirmation,” the Commission Task Force suggests that the FTC engage in litigation in which the state action doctrine is at issue, in an attempt to “strengthen” the state action standard that it feels the courts should adopt. Task Force Report, p. 3.

Furthermore, at least one Commissioner, Mr. J. Thomas Rosch, has expressed publically his personal conviction that the FTC should be more aggressive in its prosecution of cases:

When I first came to the Commission in 2006, I was, to put it politely, underwhelmed by [the FTC’s] litigation efforts. I didn’t think we were aggressive enough. I am happy to say that over the last 4.5 years, that has changed. The Commission is suing and litigating as an active prosecutor should. Since January 2009, for example, the Commission has been extraordinarily active, filing litigation in six competition matters, entering into more than two dozen consent decrees, and continuing to litigate a number of other competition matters initiated during the Bush administrative.

Rosch, J. Thomas, “So I Serve as Both a Prosecutor and a Judge – What’s the Big Deal?”, American Bar Association Annual Meeting, p. 2 (Aug. 5, 2010) (Exhibit B). In light of these remarks, Ms. Rosch’s partiality is especially acute and, if not relieved, will taint these proceedings.

See also, the Commission’s press release dated June 17, 2010, attached hereto as Exhibit C, and entitled “Federal Trade Commission Complaint Charges Conspiracy to

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<sup>3</sup> The Commission even goes so far as to categorize the state action doctrine as the “state action defense” – blatantly miscategorizing the reservation of powers afforded to the states under the Tenth Amendment as a defense rather than an affirmative prerogative. The Commission also refers to the state action doctrine as “a serious impediment to achieving national competition policy goals,” which clearly shows the Commission’s prejudgment of the issues at hand. Task Force Report, p. 25.



Thwart Competition in Teeth-Whitening Services,” which was publicly released *prior to* the service of the complaint in this action on the Respondent. The press release notes in paragraph eight that:

The complaint charges that the Dental Board’s conduct is an anticompetitive conspiracy among the dentist members of the Dental Board in violation of federal law. The FTC seeks to stop the Dental Board’s illegal conduct so that North Carolina consumers can benefit from competition between dentists and non-dentists for teeth-whitening services.

The release bears the imprimatur of the Federal Trade Commission, and was issued by the Commission’s Office of Public Affairs. It was not released by Complaint Counsel, nor was Complaint Counsel associated in any way with the press release; therefore, the press release constitutes the Commission’s public views on the matter and speaks for itself with respect to the Commission’s prejudgment of its ability to fairly prosecute the complaint and to fairly exercise jurisdiction over the State Board.

The “test for disqualification has been succinctly stated as whether ‘a disinterested observer may conclude that [the Commission] has in some measure adjudged the facts as well as the law of a particular case in advance of hearing it.’” *Cinderella Career and Finishing Sch., Inc. v. FTC*, 425 F.2d 583, 591 (D.C. Cir. 1970) (quoting *Gilligan, Will & Co. v. SEC*, 267 F.2d 461, 469, *cert. denied*, 361 U.S. 896 (1959)). In this case, the statements set forth in the Task Force Report and the remarks by Commissioner Rosch are indicative of the bias and prejudgment with which the Commission has approached this present litigation. As a result, the Commission should be removed as the duly presiding ALJ and should disqualify and remove itself as the adjudicator of the State Board’s Motion to Dismiss and Complaint Counsel’s Motion for

Partial Summary Decision, in order to ensure that the State Board receives a fair and impartial administrative hearing.

**IV. The Commission Already Has Determined That the State Board Must Satisfy the Second Prong of the *Midcal* Test to Establish State Action Doctrine Immunity.**

In 2008, the Commission initiated an investigation of the State Board. During this investigation, the Commission staff conducted investigational hearings of two (2) current Board members of the State Board and four (4) staff members. On or about March 6, 2008, the Commission, acting through staff, issued ten (10) specifications, requesting detailed information about the members of the State Board, state statutes and regulations, Board procedures, Board minutes, enforcement activities against the unauthorized practice of dentistry in the form of teeth whitening, and third party communications regarding teeth whitening by non-dentists. The specifications also requested that all documents relating to the same be produced. The State Board produced thousands of pages of documents in response to the specifications on April 28, 2008, June 26, 2008, and March 31, 2009.

The Commission, acting through staff, subsequently issued a Subpoena Duces Tecum to the State Board on February 24, 2009, which contained eight (8) specifications. The specifications requested similar information as the specification of March 6, 2008, and all of related documents. In response to the Subpoena Duces Tecum, the State Board produced documents on April 20, 2009, June 12, 2009, June 29, 2009, and June 30, 2009.

Upon information and belief, in May 2010, the Commission voted to issue the administrative complaint (“Complaint”) recommended by the Commission’s staff members who had been conducting the investigation of the State Board. In so voting, the



Commission reached the legal conclusion that the State Board was subject to, and had violated, the FTC Act, as the Complaint provides that the State Board acted “without any legitimate justification or defense, including the ‘state action’ defense.”

Furthermore, the Commission’s prejudgment of the State Board’s lack of entitlement to the “state action defense” already has been acknowledged by the ALJ currently presiding over this proceeding. At the prehearing conference on July 14, 2010, the following dialogue between the ALJ and the State Board’s counsel took place:

JUDGE CHAPPELL: You see that the complaint actually states that there is no state action defense. You saw that, right?

MR. ALLEN: Yes, Your Honor. I did.

JUDGE CHAPPELL: **Do you really think that the people who voted out the complaint didn't consider the law before they made that decision? Do you think they forgot something?**

MR. ALLEN: They are fundamentally wrong on this, absolutely. They do not understand this Board and the way that North Carolina structured it.

Preh’g Conf. Tr. 51:12-22 (emphasis added) (attached as Exhibit D).

To now rely upon the Commission to reconsider this legal conclusion in ruling upon the currently-pending dispositive motions would be a futile exercise, in light of the facts already considered and the decisions already made by the Commission during the investigation of the State Board. Therefore, the Commission should be removed as the duly presiding ALJ and should disqualify and remove itself as the adjudicator of the State Board’s Motion to Dismiss and Complaint Counsel’s Motion for Partial Summary Decision.

## CONCLUSION

Based on the foregoing grounds, the State Board hereby requests that the Commission disqualify and remove itself as the Administrative Law Judge and appoint as the presiding official a duly-qualified Administrative Law Judge who is not a Commissioner. The State Board further requests that the Commission remove itself as the adjudicator of the State Board's Motion to Dismiss, and the Complaint Counsel's Motion for Partial Summary Decision, both filed on November 3, 2010 and currently pending in this matter.

This the 14th day of January, 2011.

ALLEN AND PINNIX, P.A.

/s/ Noel L. Allen

By: \_\_\_\_\_

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## CERTIFICATE OF SERVICE

I hereby certify that on the 14th day of January, 2011, I electronically filed the foregoing Motion to Disqualify the Commission with the Federal Trade Commission using the Federal Trade Commission E-file system, which will send notification of such filing to the following:

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Federal Trade Commission  
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I hereby certify that the undersigned has this date served a copy of the foregoing upon the Secretary and upon all parties to this cause by electronic mail as follows:

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I also certify that I have sent courtesy copies of the document via Federal Express and electronic mail to:

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This the 14th day of January, 2011.

/s/ Noel L. Allen  
Noel L. Allen

#### **CERTIFICATION FOR ELECTRONIC FILING**

I further certify that the electronic copy sent to the Secretary of the Commission is a true and correct copy of the paper original and that I possess a paper original of the signed document that is available for review by the parties and by the adjudicator.

/s/ Noel L. Allen  
Noel L. Allen



**UNITED STATES OF AMERICA  
BEFORE THE FEDERAL TRADE COMMISSION**

**COMMISSIONERS:**      **Jon Leibowitz, Chairman**  
                                 **William E. Kovacic**  
                                 **Edith Ramirez**  
                                 **J. Thomas Rosch**  
                                 **Julie Brill (recused)**

In the Matter of	)	
	)	
THE NORTH CAROLINA [STATE] BOARD OF DENTAL EXAMINERS.	)	DOCKET NO. 9343
	)	
	)	

**PROPOSED ORDER**

Upon consideration of Respondent's Motion to Disqualify the Commission, IT IS  
HEREBY ORDERED that the State Board's motion is GRANTED and that Commission:

Shall disqualify and remove itself as the Administrative Law Judge and shall appoint as  
the presiding official over the administrative hearing a duly-qualified Administrative Law Judge  
who is not a Commissioner; and

Shall disqualify and remove itself as the adjudicator of the State Board's Motion to  
Dismiss, and the Complaint Counsel's Motion for Partial Summary Decision, both filed on  
November 3, 2010 and currently pending in this matter.

\_\_\_\_\_  
Donald S. Clark, Secretary  
Federal Trade Commission

\_\_\_\_\_  
Date



**BEFORE THE FEDERAL TRADE COMMISSION**

**COMMISSIONERS:**      **Jon Leibowitz, Chairman**  
                                 **William E. Kovacic**  
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OF DENTAL EXAMINERS. )  
\_\_\_\_\_)

**PUBLIC**

DOCKET NO. 9343

**RESPONDENT'S MOTION TO DISQUALIFY THE COMMISSION**

**EXHIBITS A - E**





OFFICE OF POLICY PLANNING

**REPORT OF THE  
STATE ACTION TASK FORCE\***

September 2003

Todd J. Zywicki, Director, Office of Policy Planning\*\*

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Alden F. Abbott, Assistant Director for Policy and Evaluation  
Bureau of Competition

\* This Report represents the views of the State Action Task Force. It does not necessarily represent the views of the Commission or any individual Commissioner. The Commission, however, has voted to authorize the Task Force to publish this Report.

\*\* The State Action Task Force was convened in July 2001 and, at that time, was headed by R. Ted Cruz, the former Director of the Office of Policy Planning. Mr. Cruz departed from the Federal Trade Commission in early February 2003.

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## EXECUTIVE SUMMARY

The state action doctrine – first articulated in *Parker v. Brown* – shields certain anticompetitive conduct from federal antitrust scrutiny when the conduct is: (1) in furtherance of a clearly articulated state policy, and (2) actively supervised by the state. Some lower courts, however, have applied the doctrine in a manner that could potentially endanger national competition goals. For example, some courts now apply the doctrine with little or no evidence that the state intended to restrain competition, and even if the anticompetitive effects spill over substantially into other states. This Report therefore recommends clarification and re-affirmation of the original purposes of the state action doctrine to help ensure that robust competition continues to protect consumers.

### Chapter I: State of the Law

Because the state action doctrine rests on principles of federalism, the doctrine shields sovereign activities of the State itself, including the actions of a state legislature, a governor, or a state supreme court, provided that these entities are acting in their sovereign capacity under the state constitution. The doctrine also extends to other, lower level entities – such as state regulatory commissions and licensing boards – provided that these entities are acting pursuant to a delegation of authority from a governmental actor with independent, sovereign status. To successfully assert a state action defense, these lower level entities must demonstrate that they have used the delegation of authority to advance the interests of the state, rather than their own interests, by showing that the alleged anticompetitive regulatory conduct: (1) is in conformity with a “clearly articulated” state policy, and (2) has been “actively supervised” by the state.

The first element, clear articulation, ensures that these entities may use anticompetitive mechanisms only if those mechanisms operate because of a deliberate and intended state policy. In assessing state policy, the key question is whether “the State as sovereign clearly intends to displace competition in a particular field with a regulatory structure.” In *Southern Motor Carriers*, for example, the Court found that the State intended to displace competition because the legislature created a regulatory scheme to set trucking rates. In other cases, the Court focused on the “foreseeability” of the anticompetitive mechanism. In *Omni*, for example, a state statute let cities regulate the construction of buildings and other structures. The city used this statute to restrict billboard placements. The Court held that, by giving the cities the authority to regulate and restrict billboard construction, the State had clearly articulated a policy of restricting billboard competition.

The second element, active supervision, ensures that the entities are acting pursuant to state policy, not their own private interests, and that the State’s regulatory program actually implements a positive regulatory policy. In evaluating this element, courts must determine “whether the State has exercised sufficient independent judgment and control so that the details” of the restraint “have been established as a product of deliberate state intervention, not simply by agreement among private parties.” There is some ambiguity in the law regarding which entities are subject to the requirement and what level of state supervision satisfies the standard. In



general, courts require active supervision of entities when there is a risk that the challenged conduct results from private actors pursuing their own interests rather than state policy. Thus, for example, the requirement generally does not apply to municipalities, but may apply to state boards, particularly those that have substantial industry participation. As far as the level of supervision is concerned, the State must "have and exercise power to actually review particular anticompetitive acts." In other words, the State must use its power actually to review the substantive merits of particular acts. It cannot simply declare a general repeal of federal antitrust law.

## **Chapter II: Recurrent Problems in the Case Law**

Today, overbroad interpretations of the state action doctrine could potentially impede national competition policy goals. Some courts broadly apply the doctrine while ignoring its original purpose – namely, to protect the deliberate policy choices of sovereign states. As a result, some courts have eroded both the clear articulation standard and the active supervision standard. Moreover, courts have also largely ignored the problems of interstate spillover effects and the increasing role of municipalities in the marketplace.

The clear articulation standard has repeatedly been interpreted too broadly. According to several appellate courts, once a state broadly authorizes certain acts or implements a general regulatory scheme for an industry, *any* anticompetitive effects flowing from the acts must have been foreseeable and are, therefore, a product of deliberate state policy. In other words, these courts equate a state's mere grant of general authority with a state's clear articulation of a policy to restrain competition. This focus on theoretical "foreseeability" leads some courts to apply the doctrine expansively, as many forms of anticompetitive conduct are arguably foreseeable in the sense that they could possibly occur. By ignoring the substance of the state's policy choice, however, this approach both contravenes Supreme Court precedent and undermines the purpose of the clear articulation standard. Making a meaningful determination of whether the state has deliberately adopted a policy to displace competition requires a court to look beyond the state's mere authorization of general regulation.

Similarly, courts have not set forth adequate guidelines regarding the active supervision standard. In evaluating whether an entity is subject to the active supervision requirement, courts examine a variety of factors, including whether the entity exercises governmental powers (like eminent domain), lacks the ability to make a private profit, and has a public nature. These factors, however, are neither specific nor tailored to the underlying goals of the active supervision standard. This conclusion stems from the fact that they are not necessarily probative of whether the entity will pursue its own private interests rather than the state's interests. For example, non-profit corporations often try to restrain competition, either for their own benefit or for the benefit of their members. Other factors, such as the entity's structure, membership, decision-making apparatus, and public openness, are better indicators of the need for active supervision.

The problems with the state action doctrine extend even further. Much of the doctrine



also ignores interstate spillovers, which force citizens of one state to absorb the sometimes substantial costs imposed by another state's anticompetitive regulations. A "negative externality," interstate spillovers can cause significant efficiency losses. Nevertheless, most courts have not yet incorporated these costs into their analysis.

Finally, the doctrine may not adequately account for municipalities that participate in the marketplace. Municipalities are increasingly engaged in business on a profit-making basis, and use their law-making power to exclude competitive challenges. While there is some support, at both the Supreme Court and lower court levels, for a "market participant" exception that would potentially address this problem, courts have hesitated to embrace such an exception fully, and a few have rejected it outright.

### **Chapter III: Possible Approaches**

To address these problems, the Report suggests that the Commission – through litigation, *amicus* briefs, and competition advocacy – implement the following recommendations:

- *Re-affirm a clear articulation standard tailored to its original purposes and goals.* An appropriate clear articulation standard would ask both (i) whether the state authorized the conduct at issue, and (ii) whether the state deliberately adopted a policy to displace competition in the manner at issue.
- *Clarify and strengthen the standards for active supervision.* An appropriate active supervision standard would encompass the following parameters: (a) a finding of active supervision must be based on a determination that the state official's decision was rendered after consideration of the relevant factors; (b) the absence of an adequate factual record precludes a finding of active supervision; and (c) the use of specific procedural measures – such as notice to the public, opportunity for comment, and a written decision – is significant, though not necessarily conclusive, evidence of active supervision.
- *Clarify and rationalize the criteria for identifying the quasi-governmental entities that should be subject to active supervision.* The category of entities subject to the active supervision requirement would include either: (a) any market participant, or (b) any situation with an appreciable risk that the challenged conduct results from private actors' pursuing private interests, rather than from state policy.
- *Encourage judicial recognition of the problems associated with overwhelming interstate spillovers, and consider such spillovers as a factor in case and amicus/advocacy selection.* Although courts are understandably reluctant to interfere with purely intrastate regulatory regimes, they should consider the problem of interstate spillovers when the benefits of the anticompetitive regulation accrue overwhelmingly to in-state parties and the costs fall overwhelmingly on out-of-state parties.



- *Undertake a comprehensive effort to address emerging state action issues through the filing of amicus briefs in appellate litigation.* As demonstrated by past Commission involvement, the Commission can play an important role in helping to explain the value of competition policy to the federal courts.

#### **Chapter IV: Prior Commission Litigation Involving State Action**

The Commission has a long history of commenting on, and challenging, potentially anticompetitive state regulation. For example, the Commission's litigation and advocacy efforts in the taxicab area led to several new, procompetitive state laws. The Commission's other notable forays into the area of state regulation include: the Ophthalmic Practice Rules ("Eyeglasses II"); the *Superior Court Trial Lawyers' Association* case, involving boycott conduct; and the *Ticor Title* case, addressing rate-setting.

#### **Chapter V: Recent Commission Activities Involving State Action**

In the nearly two years since its formation, the Task Force, working closely with FTC enforcement staff, has endeavored to address important state action issues whenever they arise. The most recent efforts of the Task Force have included both litigation and competition advocacy. With respect to litigation, the Commission recently entered into a consent order with *Indiana Movers and Warehousemen, Inc.* The Analysis to Aid Public comment that accompanied that consent order provided the Commission with an opportunity to offer clear and authoritative guidance regarding the requirements of the "active supervision" prong of *Midcal*. The Commission subsequently entered into consent orders with two additional household good movers associations – in Minnesota and Iowa – and filed complaints against three others – in Alabama, Kentucky, and Mississippi.

With respect to competition advocacy, recent Commission efforts involving state action issues include letters to state legislators in: Ohio, Washington, and Alaska, regarding physician collective bargaining; Rhode Island, Georgia, and North Carolina, regarding licensing requirements for participants in real estate closings; and Virginia, regarding mandatory minimum mark-ups on gasoline. The Internet Task Force, dedicated to addressing state regulation with a disparate impact on e-commerce, has also worked with Commission staff to file comments regarding Connecticut's regulation of Internet contact lens sales and Oklahoma's regulation of Internet casket sales. In addition, in October 2002, the Commission hosted a public workshop on Possible Anticompetitive Efforts to Restrict Competition on the Internet. The Internet Task Force anticipates that it will continue to engage in a substantial amount of competition advocacy.



## CHAPTER I

### STATE OF THE LAW

#### A. Basis of the State Action Doctrine

The state action doctrine is the product of the Supreme Court's 1943 opinion in *Parker v. Brown*,<sup>1</sup> which reasoned that, in light of states' sovereign status and principles of federalism, Congress would not have intruded on state prerogatives through the Sherman Act without expressly saying so. As the Court explained:

"We find nothing in the language of the Sherman Act or in its history which suggests that its purpose was to restrain a state or its officers or agents from activities directed by the legislature. In a dual system of government in which, under the Constitution, the states are sovereign, save only as Congress may constitutionally subtract from their authority, an unexpressed purpose to nullify a state's control over its officers and agents is not lightly to be attributed to Congress."<sup>2</sup>

This refrain runs through Supreme Court jurisprudence up through its most recent state action opinion, *Federal Trade Commission v. Ticor Title Insurance Co.*,<sup>3</sup> in which the Court emphasized, "Our decision [in *Parker*] was grounded in principles of federalism."<sup>4</sup>

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<sup>1</sup> 317 U.S. 341.

<sup>2</sup> *Id.* at 350-51. *Parker* went on to clarify that "a state does not give immunity to those who violate the Sherman Act by authorizing them to violate it, or by declaring that their action is lawful." *Id.* at 351.

<sup>3</sup> 504 U.S. 621, 633 (1992).

<sup>4</sup> This derivation of the doctrine establishes the boundaries for the current debate regarding the scope of the state action defense. Although the Court has held that the state action doctrine is grounded in principles of federalism, it has never fully explained how federalism justifies the current form of the defense. The Court has merely observed that, in passing the Sherman Act, Congress did not intend to preempt all state economic policies that might conflict with federal antitrust law, but did intend to preempt those policies that served no other purpose (*i.e.*, so-called "naked" repeals). The ultimate task, therefore, is "to define the scope of state-sanctioned anticompetitive conduct to which Congress intended to defer in light of the appropriate role of federalism in shaping economic policy." John E. Lopatka & William H. Page, *Narrowing the Scope of the State Action Doctrine: Report Prepared for the Federal Trade Commission*, 4 (2001).



## B. Defining "The State"

Given a doctrine that sets state conduct beyond the reach of the antitrust laws, it becomes necessary at the start to delineate what constitutes the actions of a state.<sup>5</sup> The Supreme Court has established that actions of the state itself, acting as sovereign, are covered by the state action doctrine by their very nature and without further inquiry. As explained in *Hoover v. Ronwin*, "When the conduct is that of the sovereign itself . . . the danger of unauthorized restraint of trade does not arise."<sup>6</sup> "The only requirement," the Court continued, "is that the action be that of the State acting as a sovereign."<sup>7</sup> Outside of this designated sphere of sovereign activity, however, any delegated state activity must satisfy the clear articulation requirement of *Midcal*. Indeed, the vast majority of delegated activities must satisfy *both* the clear articulation and active supervision requirements.

At one end of the spectrum, there is a relatively small group of cases that address the direct actions of a sovereign state authority. The case law is quite clear that the actions of a state legislature<sup>8</sup> and of a state supreme court<sup>9</sup> acting in a legislative fashion are those of the state acting as sovereign and are covered by the state action doctrine without need for further inquiry. As the Supreme Court stated in *Hoover*, "[w]here the conduct at issue is in fact that of the state legislature or supreme court, we need not address the issues of 'clear articulation' and 'active supervision.'"<sup>10</sup> Although there is little case law on the sovereign status of governors, some commentators have argued that governors should at least sometimes be entitled to the same state action defense as actions of the state legislature or the state supreme court. Because governors do not have the power to determine state policy in all respects, the state constitution and statutes should determine when the governor is acting in a sovereign capacity.<sup>11</sup> At the other end of

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<sup>5</sup> Determining whether a particular governmental entity constitutes "the state" is also important to the active supervision analysis, as that analysis is required to ensure that private actors comply with the dictates of state policy. If the entity in questions clearly constitutes "the state," no such analysis is required. See *infra* Chapter I.D.2.

<sup>6</sup> 466 U.S. 558, 569 (1984).

<sup>7</sup> *Id.* at 574 (internal quotation omitted).

<sup>8</sup> See *Parker*, 317 U.S. at 350-52.

<sup>9</sup> See *Bates v. State Bar of Arizona*, 433 U.S. 350 (1977).

<sup>10</sup> *Hoover*, 466 U.S. at 569.

<sup>11</sup> The Areeda and Hovenkamp treatise would "certainly" treat the governor's office under the "state itself" designation. See Phillip E. Areeda and Herbert Hovenkamp, *ANTITRUST LAW: AN ANALYSIS OF ANTITRUST PRINCIPLES AND THEIR APPLICATION* ¶ 224, at 405 (2d ed. 2000). Professors Lopatka and Page agree, but would limit that designation to the governor only,



the spectrum, there is a much larger group of cases that address the actions of a non-sovereign entity acting pursuant to a *delegation* of state authority. Cities, for example, are ineligible for "sovereign" treatment. "Cities are not themselves sovereign; they do not receive all the federal deference of the States that create them."<sup>12</sup> For a municipality to qualify for the state action defense, it must be engaging in the challenged activity pursuant to *state* policy.<sup>13</sup> The courts have been similarly consistent in holding that special purpose instrumentalities lack independent sovereign status. A state Public Service Commission, for example, is not sovereign and may not articulate state policy.<sup>14</sup> The same is true of state regulatory boards.<sup>15</sup>

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excluding all other executive branch authorities. See Lopatka & Page, *supra* note 4, at 32-33. In their view, "the foundation of the state action doctrine – a respect for the sovereign power of states coupled with the background norm of competition as a fundamental national policy – counsels that no executive branch official or agency, with the likely exception of the governor himself, should be considered the state itself. The strongest argument for this conclusion is based on political legitimacy." *Id.* at 33. In contrast, Professor Floyd would extend such treatment to all public authorities having the power to formulate a general policy in favor of the anticompetitive arrangements for the state as a whole and to determine that the specific arrangement in question falls within that policy. See C. Douglas Floyd, *Plain Ambiguities in the Clear Articulation Requirement for State Action Antitrust Immunity: The Case of State Agencies*, 41 B.C. L. REV. 1059, 1081-82 (2000).

<sup>12</sup> *City of Lafayette v. Louisiana Power & Light Co.*, 435 U.S. 389, 412 (1978).

<sup>13</sup> *Town of Hallie v. City of Eau Claire*, 471 U.S. 34, 40 (1985).

<sup>14</sup> *Southern Motor Carriers Rate Conference, Inc. v. United States*, 471 U.S. 48, 62-63 (1985). See also *Bolt v. Halifax Medical Center*, 891 F.2d 810, 823 (11th Cir. 1990) (special taxing district "not a state agency acting as sovereign"); *Hass v. Oregon State Bar*, 883 F.2d 1453, 1456 (9th Cir. 1989) (bar association's requirement that attorneys purchase its malpractice insurance "not an act of the state in its sovereign capacity"); *Cine 42<sup>nd</sup> Street Theater Corp. v. Nederlander Organization, Inc.*, 790 F.2d 1032, 1044 (2d Cir. 1986) (Urban Development Corporation not the state). But see *Automated Salvage Transport, Inc. v. Wheelabrator Environmental Systems, Inc.*, 155 F.3d 59 (2d Cir. 1998) (finding basis for regarding Connecticut Resources Recovery Authority as state acting as sovereign, but deciding the case on other grounds).

<sup>15</sup> See, e.g., *Earles v. State Board of Certified Public Accountants*, 139 F.3d 1033, 1040-41 (5th Cir. 1998) (actions of members of state regulatory board require greater scrutiny than actions of the state itself); *Federal Trade Commission v. Monahan*, 832 F.2d 688 (1st Cir. 1987) (state Board of Registration in Pharmacy denied *ipso facto* immunity); *Massachusetts Bd. of Registration in Optometry*, 110 F.T.C. 549, 612-13 (1988) (state optometry board "not entitled to immunity as the sovereign"). See generally *Washington State Electrical Contractors Ass'n v. Forrest*, 930 F.2d 736 (9th Cir. 1991) (rejecting "state agency" treatment for wage-setting council and requiring consideration of both clear articulation and active supervision). But see



## C. Clear Articulation

For cases involving non-sovereign state activities or activities of municipalities or private actors, the Court has employed a more searching inquiry. Under the two-pronged standard set out in *California Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc.*, "the challenged restraint must be 'one clearly articulated and affirmatively expressed as state policy'" and "the policy must be 'actively supervised' by the State itself."<sup>16</sup>

### 1. General Purposes

The clear articulation requirement, along with the active supervision element, is "directed at ensuring that particular anticompetitive mechanisms operate because of a deliberate and intended state policy."<sup>17</sup> It mitigates any "concern that federal policy is being unnecessarily and inappropriately subordinated to state policy."<sup>18</sup> As the Areeda and Hovenkamp treatise explains:

"Adoption of a policy requiring a state to make a clear statement of its intention to supplant competition reconciles the interests of the states in adopting noncompetitive policies with the strong national policy favoring competition . . . it ensures that the strong federal policy embodied in the antitrust laws will not be set aside where not intended by the state, and yet also guarantees that the state will not be prevented by the antitrust laws alone from supplanting those laws as long as it makes its purpose clear."<sup>19</sup>

### 2. Nature of the Required Showing

To satisfy the "clear articulation" standard, the case law provides that the state need not compel the anticompetitive conduct at issue: "the federal antitrust laws do not forbid the States to

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*Green v. State Bar of Texas*, 27 F.3d 1083 (5th Cir. 1994) (according "state" treatment to Unauthorized Practice of Law Committee).

<sup>16</sup> 445 U.S. 97, 97 (1980) (quoting *City of Lafayette*, 435 U.S. at 410).

<sup>17</sup> *Ticor*, 504 U.S. at 636.

<sup>18</sup> *Bates*, 433 U.S. at 362.

<sup>19</sup> Areeda & Hovenkamp, *supra* note 11, at 374. See also Thomas M. Jorde, *Antitrust and the New State Action Doctrine: A Return to Deferential Economic Federalism*, 75 CAL. L. REV. 227, 248 (1987) ("The clear articulation requirement asks a state to indicate plainly that shielded conduct is indeed that of the state, and thus it enables a court to identify – and limit – anticompetitive conduct that is entitled to exemption on grounds of economic federalism."); Floyd, *supra* note 11, at 1109 ("It is designed to ensure that even an authorized state decision-maker does not repeal the fundamental national policy of the antitrust laws without clear recognition of what it is doing and a deliberate decision to act in that way.").



adopt policies that permit, but do not compel, anticompetitive conduct.”<sup>20</sup> On the other hand, a very general grant of power to enact ordinances is not sufficient.<sup>21</sup> What *is* needed is a clearly articulated and affirmatively expressed state policy to displace competition. The critical question is whether “the State as sovereign *clearly* intends to displace competition in a particular field with a regulatory structure.”<sup>22</sup> The clear articulation must come from the state as sovereign.<sup>23</sup> A municipality, for example, must be able to point back to some articulation by the state.<sup>24</sup>

The Court has not developed a self-operating, readily applicable formula for resolving clear articulation issues.<sup>25</sup> Instead, it has described a general methodology and provided individual points of reference against which other fact patterns must be compared. Repeatedly, the Court has stressed the underlying need that the state, either expressly or by implication, manifest its clear intention to displace competition.

Only one post-*Midcal* opinion has rejected clear articulation claims. *Community Communications Co. v. City of Boulder* dealt with Colorado’s constitutional provision for home rule municipalities, which entitled cities to exercise the full right of self-government. Boulder declared a moratorium on cable development, thereby preventing an incumbent in part of the city from obtaining a first-mover advantage in other parts before the city could develop a cable franchising policy. The Court reasoned that rather than presenting a clearly articulated and affirmatively expressed state policy, the home rule provisions merely expressed neutrality

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<sup>20</sup> *Southern Motor Carriers*, 471 U.S. at 60. *Town of Hallie* further noted that there need not be express, specific authorization for the challenged conduct, 471 U.S. at 64-65, or an express statement that the state expected the actor to engage in conduct that would have anticompetitive effects, *id.* at 41-44.

<sup>21</sup> *Community Communications Co. v. City of Boulder*, 455 U.S. 40 (1982).

<sup>22</sup> *Southern Motor Carriers*, 471 U.S. at 64 (emphasis added).

<sup>23</sup> *Id.*

<sup>24</sup> *Town of Hallie*, 471 U.S. at 38-40.

<sup>25</sup> See Areeda & Hovenkamp, *supra* note 11, at 446 (“the meaning of ‘foreseeable’ [one of the formulations used by the Court] is not self-evident”); Floyd, *supra* note 11, at 1074-75 (“The Supreme Court has struggled to define how specifically a state must approve particular anticompetitive conduct.”); Einer Richard Elhauge, *The Scope of Antitrust Process*, 104 HARV. L. REV. 668, 674 (1991) (“The clear articulation requirement has proved hard to apply.”); Daniel J. Gifford, *Federalism, Efficiency, the Commerce Clause, and the Sherman Act: Why We Should Follow a Consistent Free-Market Policy*, 44 EMORY L.J. 1227, 1229 and n.5 (1995) (the Court has experienced “enormous difficulties in establishing a workable and credible case law” with reference to the applicability of state action doctrine to local governments).



respecting the alleged anticompetitive conduct.<sup>26</sup> Acceptance of the proposition that “the general grant of power to enact ordinances necessarily implies state authorization to enact specific anticompetitive ordinances,” the Court explained, “would wholly eviscerate the concepts of ‘clear articulation and affirmative expression’ that our precedents require.”<sup>27</sup>

Three cases that found clear articulation warrant additional discussion.<sup>28</sup> *Town of Hallie* looked to the foreseeability of anticompetitive effects as a tool for ascertaining the state’s intentions. The case dealt with complaints by unincorporated townships that the city of Eau Claire provided sewage treatment services only to areas that also used its sewage collection and transportation services. The Court held that the legislature need not expressly state that it expected the city to engage in conduct with anticompetitive effects. Rather, it sufficed that anticompetitive conduct was “a foreseeable result” (*i.e.*, that the state had delegated “the express authority to take action that foreseeably will result in anticompetitive effects.”).<sup>29</sup> The relevant statutes conferred authority to provide sewage services and to determine the areas to be served and expressly provided that there would be no obligation to provide service beyond the area so delineated.<sup>30</sup> The Court reasoned that anticompetitive conduct – in the form of refusing to serve or imposing conditions on agreeing to serve – was a foreseeable result of empowering the cities to determine the areas to be served and to refuse to serve unannexed areas.<sup>31</sup> It explained: “We think it clear that anticompetitive effects logically would result from this broad authority to regulate.”<sup>32</sup> Accordingly, the Court concluded that the statutes evidenced “a state policy to displace competition” and that the legislature had “contemplated the kind of action complained of.”<sup>33</sup>

The Court again spoke in terms of foreseeability in *City of Columbia v. Omni Outdoor*

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<sup>26</sup> 455 U.S. at 55.

<sup>27</sup> *Id.* at 56.

<sup>28</sup> Other cases, including *Midcal* itself, 445 U.S. at 105, have found clear articulation without significant explanation. *See, e.g., 324 Liquor Corp. v. Duffy*, 479 U.S. 335, 344 (1987) (providing as clear articulation analysis the following two sentences: “New York’s liquor-pricing system meets the first [*Midcal*] requirement. The state legislature clearly has adopted a policy of resale price maintenance.”).

<sup>29</sup> 471 U.S. at 42-43.

<sup>30</sup> *Id.* at 41.

<sup>31</sup> *Id.* at 41-42.

<sup>32</sup> *Id.* at 42.

<sup>33</sup> *Id.* at 44 (internal quotation omitted).



*Advertising.*<sup>34</sup> Under the aegis of a statute authorizing municipal regulation of land use and construction of buildings and other structures, a city ordinance had restricted the size, location, and spacing of billboards. When a recent entrant into the city's billboard market complained, clear articulation was readily found. As in *Town of Hallie*, the Court found no need that the delegating statute explicitly permit displacement of competition. It sufficed that suppression of competition was the foreseeable result of what the statute authorized.<sup>35</sup> The Court reasoned that "[t]he very purpose of zoning regulation is to displace unfettered business freedom in a manner that regularly has the effect of preventing normal acts of competition, particularly on the part of new entrants," and observed that billboard zoning ordinances "necessarily" protect existing billboards from competition from newcomers.<sup>36</sup>

In contrast, the *Southern Motor Carriers* opinion, released the same day as *Town of Hallie*, never mentioned "foreseeability" in finding clear articulation with reference to alleged anticompetitive conduct by regulated private parties. Mississippi's statutory scheme set up a system of rate regulation for intrastate trucking activities, charging a public service commission with responsibility to establish just and reasonable rates. The statute did not specifically address collective ratemaking, and the United States challenged the motor carriers' submission of joint rate proposals for commission approval. The Court focused its clear articulation inquiry on the state's intention to displace competition: "As long as the State as sovereign clearly intends to displace competition in a particular field with a regulatory structure, the first prong of the *Midcal* test is satisfied."<sup>37</sup> The Court reasoned that the legislature's determination to set rates through the regulatory actions of the public service commission rather than through market forces revealed an intention to displace competition in motor carrier ratemaking and satisfied the clear articulation requirement.<sup>38</sup>

The absence of any reference to "foreseeability" in *Southern Motor Carriers* reflects the fact that "foreseeability" is merely a useful tool in inquiring about state policy to displace competition. It is not an end in itself. Some lower courts, however, have adopted a far more expansive interpretation of *Town of Hallie*, confusing authority with policy and effectively

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<sup>34</sup> 499 U.S. 365 (1991).

<sup>35</sup> *Id.* at 372-73.

<sup>36</sup> *Id.* at 373.

<sup>37</sup> 471 U.S. at 64. The Court continued: "[W]e hold that if the State's intent to establish an anticompetitive regulatory program is clear, as it is in Mississippi, the State's failure to describe the implementation of its policy in detail will not subject the program to the restraints of the federal antitrust laws." *Id.* at 64-65.

<sup>38</sup> *Id.* at 65 n.25. The Court distinguished the situation in *City of Boulder*, where the Home Rule provision did not evidence any intent to displace competition in the cable television industry. *Id.*



turning the state action doctrine into a lowest common denominator rule. These cases are described in more detail in Chapter II.A.1.

Although they have also acted on the basis of an overbroad reading of *Town of Hallie*, some courts have moved toward a “tiered” approach to the state action doctrine – for example, by accepting different levels of supervision depending on the circumstances. The Court itself alluded to such an approach in *Ticor*, stating that “[o]ur decision should be read in light of the gravity of the antitrust offense” and “the involvement of private actors throughout.”<sup>39</sup> The decision in *Town of Hallie* to exempt municipalities entirely from the active supervision prong of *Midcal* might be argued to reveal tiered approach thinking writ large.

This emerging tiered approach might at least provide courts with the beginnings of an exit from the lowest common denominator paradigm. The tiered approach would potentially give different meaning to the terms “clear articulation” and “active supervision” in different circumstances. Depending on certain key factors – primarily, the nature of the anticompetitive practice and the nature of the party engaged in that practice – the rigor with which the *Midcal* factors are applied would either remain at the current, baseline level or be increased. The baseline level of rigor would apply only in the least problematic cases, like *Town of Hallie*. By contrast, if the practice at issue were price fixing, the affirmatively articulated state policy would need to be extremely detailed and activity-specific. Likewise, if a regulatory scheme contemplated that private actors, rather than an electorally-accountable entity, would implement the rate-setting, then the most rigorous level of active supervision would apply.

#### **D. Active Supervision**

The second prong of *Midcal* requires active state supervision of parties claiming to act pursuant to state policy.

##### **1. General Purpose**

As explained by the Supreme Court in *Town of Hallie*, “the requirement of active state supervision serves essentially an evidentiary function: it is one way of ensuring that the [private] actor is engaging in the challenged conduct pursuant to state policy” rather than in pursuit of private interests.<sup>40</sup> As the Court further explained, “[w]here a private party is engaging in the anticompetitive activity, there is a real danger that he is acting to further his own interests, rather

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<sup>39</sup> *Ticor*, 504 U.S. at 639. The Court explained, “This case involves horizontal price fixing . . . . No antitrust offense is more pernicious than price fixing. In this context, we decline to formulate a rule that would lead to a finding of active state supervision where in fact there was none.” *Id.*

<sup>40</sup> 471 U.S. at 46.



than the governmental interests of the State.”<sup>41</sup>

The active supervision test operates by according state action protection only when the challenged conduct can be said to be that of the state rather than private actors. The test thus seeks to determine “whether the State has exercised sufficient independent judgment and control so that the details” of the restraint “have been established as a product of deliberate state intervention, not simply by agreement among private parties.”<sup>42</sup> “Much as in causation inquiries, the analysis asks whether the State has played a substantial role in determining the specifics of the economic policy.”<sup>43</sup>

The origins of the active supervision test reach back to *Parker v. Brown*, where the Court emphasized that the conduct in question was not simply authorized by the state but also adopted and enforced by a state commission: “Although the organization of a prorate zone is proposed by producers, and a prorate program, approved by the Commission, must also be approved by referendum of producers, it is the state, acting through the Commission, which adopts the program and which enforces it with penal sanctions, in the execution of a governmental policy.”<sup>44</sup>

As explained by Professors Page and Lopatka, the active supervision requirement ensures that the state’s regulatory program “actually implements a positive regulatory policy.”<sup>45</sup> In their view, the state action doctrine under *Midcal* is shaped both by a background norm of federalism that affects the interpretation of the Sherman Act, and by a background national policy favoring competition and enforced by prohibitions on certain restraints by private actors.<sup>46</sup> This means, in their view, that a state may not simply nullify antitrust prohibitions, which would amount to a naked repeal of the antitrust laws. Rather, a state may authorize restraints only insofar as they are ancillary to a positive regulatory program.<sup>47</sup> Further, since “states can easily assert a plausible public interest rationale for virtually any legislation,” Professors Page and Lopatka maintain that active supervision is required in order to ensure that the state actually implements a positive

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<sup>41</sup> *Id.* at 46-47.

<sup>42</sup> *Ticor*, 504 U.S. at 634.

<sup>43</sup> *Id.* at 635.

<sup>44</sup> 317 U.S. at 352.

<sup>45</sup> William H. Page & John E. Lopatka, *State Regulation in the Shadow of Antitrust: FTC v. Ticor Title Insurance Co.*, 3 SUP. CT. ECON. REV. 189, 210 (1993).

<sup>46</sup> *Id.* at 201.

<sup>47</sup> *Id.* at 201-03. The authors analogize this distinction to that between naked and ancillary restraints in antitrust law.



policy of regulation.<sup>48</sup>

The Page and Lopatka view of active supervision is consistent with the *Parker* Court's statement that "a state does not give immunity to those who violate the Sherman Act . . . by declaring that their action is lawful,"<sup>49</sup> as well as *Midcal*'s declaration that a state may not circumvent the Sherman Act's proscriptions "by casting . . . a gauzy cloak of state involvement over what is essentially a private price-fixing arrangement."<sup>50</sup>

While the active supervision requirement is designed to ensure that the state action doctrine will shelter only "the particular anticompetitive acts of private parties that, in the judgment of the State, actually further state regulatory policies,"<sup>51</sup> the Court has cautioned that "the purpose of the active supervision inquiry is not to determine whether the State has met some normative standard, such as efficiency, in its regulatory practices. Its purpose is to determine whether the State has exercised sufficient independent judgment and control so that the details of the rates or prices have been established as a product of deliberate state intervention, not simply by agreement among private parties."<sup>52</sup>

Finally, the Court in *Ticor* explained that the active supervision requirement further serves to assign political responsibility for the state's actions:

"States must accept political responsibility for actions they intend to undertake. It is quite a different matter, however, for federal law to compel a result that the States do not intend but for which they are held to account. Federalism serves to

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<sup>48</sup> *Id.* at 207-08. Another author opines that "[t]he continued vitality of the supervision requirement represents an attempt by the Court to reconcile federalism concerns with the practical problems inherent in delegating regulatory power: a private party could carry out an initially authorized scheme in a manner inconsistent with state policy." Mark A. Perry, *Municipal Supervision and State Action Antitrust Immunity*, 57 U. CHI. L. REV. 1413, 1417-18 (1990). Perry argues that federal courts are ill-equipped to evaluate whether private actors operated in a manner consistent with state policy, and that assessment should, in any event, be made by the state itself. But a federal court presented with an antitrust claim must have some means of evaluating whether the state has in fact made that determination. The supervision requirement serves as a proxy for that assessment. It "thus ensures that only those activities that accord with state interests, and thus can truly be called 'state action,' will escape federal antitrust liability." *Id.* at 1418.

<sup>49</sup> 317 U.S. at 351.

<sup>50</sup> 445 U.S. at 106. *See also* *Town of Hallie*, 471 U.S. at 46-47 (quoting *Midcal*).

<sup>51</sup> *Patrick v. Burget*, 486 U.S. 94, 100-01 (1988).

<sup>52</sup> *Ticor*, 504 U.S. at 634.



assign political responsibility, not to obscure it. Neither federalism nor political responsibility is well served by a rule that essential national policies are displaced by state regulations intended to achieve more limited ends. For States which do choose to displace the free market with regulation, our insistence on real compliance with both parts of the *Midcal* test will serve to make clear that the State is responsible for the price fixing it has sanctioned and undertaken to control.”<sup>53</sup>

Professors Inman and Rubinfeld,<sup>54</sup> as well as Professor Jorde,<sup>55</sup> state that the active supervision requirement positively promotes the citizen participation value of federalism. As explained by Jorde, “[l]eft to their own devices, private parties can hardly be expected to provide the public the same opportunity to participate in a delegated regulatory decisionmaking process that can reasonably be expected of state and municipal units of government. Viewed in this light, active supervision by a governmental unit of private delegations is needed to provide an opportunity for citizen participation.”<sup>56</sup>

## 2. Entities Subject to Supervision

The active supervision test is applied when the court deems there to be an appreciable risk that the challenged conduct may be the product of parties pursuing their own interests rather than state policy. As explained by Professors Areeda and Hovenkamp, the need for active supervision turns on whether the relevant actor is private or public.<sup>57</sup> It is well settled that purely private actors claiming to act pursuant to state policy are subject to the active supervision test, while municipalities are not subject to that requirement. As the Court explained in *Town of Hallie*:

“Where the actor is a municipality, there is little or no danger that it is involved in a *private* price-fixing arrangement. The only real danger is that it will seek to further purely parochial public interests at the expense of more overriding state goals. This danger is minimal, however, because of the requirement that the municipality act pursuant to a clearly articulated state policy. Once it is clear that

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<sup>53</sup> *Id.* at 636.

<sup>54</sup> Robert P. Inman & Daniel L. Rubinfeld, *Making Sense of the Antitrust State-Action Doctrine: Balancing Political Participation and Economic Efficiency in Regulatory Federalism*, 75 TEX. L. REV. 1203, 1257, 1260-63 (1997).

<sup>55</sup> Jorde, *supra* note 19, at 249.

<sup>56</sup> *Id.*

<sup>57</sup> Areeda & Hovenkamp, *supra* note 11, at 490. Professors Areeda and Hovenkamp further note that “[d]istinguishing private from public actors and actions has proved to be a vexatious question, as illustrated by its various doctrinal manifestations.” *Id.*



state authorization exists, there is no need to require the State to supervise actively the municipality's execution of what is a properly delegated function."<sup>58</sup>

A municipality's involvement in the challenged conduct also may shield private actors from the active supervision requirement. For example, where a municipality is the effective decision-maker and private actors have no discretionary authority with respect to the challenged conduct, one court has held that it need not apply the active supervision test to the private actors.<sup>59</sup> Similarly, if a state or local governmental entity would be entitled to a state action defense for the alleged conduct, private actors working in concert with the entity or under its direction may also be entitled to share the defense without a showing of active supervision.<sup>60</sup>

Characterization of the relevant actor is more difficult when the entity in question is not purely private, and involves a combination of public and private attributes. As stated by the Eleventh Circuit, the determination of whether an entity is subject to the active supervision requirement for purposes of a state action defense is based on "whether the nexus between the State and the [entity in question] is sufficiently strong that there is little real danger that the [entity] is involved in a *private* price-fixing arrangement."<sup>61</sup> Another Eleventh Circuit case, surveying cases in various circuits, identified the following as factors potentially exempting an entity from active supervision: "open records, tax exemption, exercise of governmental functions, lack of possibility of private profit, and the composition of the entity's decisionmaking

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<sup>58</sup> *Town of Hallie*, 471 U.S. at 47 (emphasis in original).

<sup>59</sup> *Zimomra v. Alamo Rent-A-Car, Inc.*, 111 F.3d 1495 (10th Cir. 1997).

<sup>60</sup> *A.D. Bedell Wholesale Company, Inc. v. Philip Morris Inc.*, 263 F.3d 239, 256 n.35 (3d Cir. 2001) (emphasis in original). See also *Armstrong Surgical Ctr., Inc. v. Armstrong County Mem'l Hosp.*, 185 F.3d 154, 159 (3d Cir. 1999) ("[I]f relief is sought solely for injury as to which the state would enjoy immunity under *Parker*, the private petitioner also enjoys immunity."); *Cine 42<sup>nd</sup> Street*, 790 F.2d at 1048.

<sup>61</sup> *Crosby v. Hospital Auth. of Valdosta and Lowndes County*, 93 F.3d 1515, 1524 (11th Cir. 1996) (citing *Town of Hallie*; emphasis in original). The determination of whether an entity is a political subdivision of a state for purposes of a state action defense is a matter of federal law. *Id.* at 1524 (holding that the definition of political subdivision for purposes of state sovereign immunity under state law is not controlling). Cf. *Todorov v. DCH Healthcare Authority*, 921 F.2d 1438 (11th Cir. 1991) (relying heavily on characterization under state statute but also looking at governmental attributes).



structure.<sup>62</sup> Entities such as hospital authorities,<sup>63</sup> transportation authorities,<sup>64</sup> electric cooperatives,<sup>65</sup> and government-affiliated charitable or nonprofit corporations<sup>66</sup> have sometimes

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<sup>62</sup> *Bankers Insurance Co. v. Florida Residential Property & Casualty Joint Underwriting Ass'n*, 137 F.3d 1293 (11th Cir. 1998).

<sup>63</sup> *See, e.g., Crosby*, 93 F.3d at 1515; *Federal Trade Commission v. Hospital Bd. of Directors of Lee County*, 38 F.3d 1184 (11th Cir. 1994) (healthcare authority created by Florida legislature as a special purpose unit of local government); *Bolt v. Halifax Hosp. Medical Center*, 891 F.2d 810 (11th Cir. 1990) (hospital created and operated by a special taxing district of the State of Florida has powers granted in its enabling legislation that are "in many important aspects identical to the powers of a Florida municipality").

<sup>64</sup> *See, e.g., Interface Group, Inc. v. Massachusetts Port Authority*, 816 F.2d 9 (1st Cir. 1987) (observing that the port authority resembles a municipal corporation and has governmental attributes); *Commuter Transportation Systems v. Hillsborough County Aviation Auth.*, 801 F.2d 1286 (11th Cir. 1986) (Authority "created as a public instrumentality of the Florida legislature to develop and administer public airports" is analogous to a municipality; it is subject to state "sunshine" laws, has police power, power of eminent domain, zoning authority, bonding authority, and rulemaking power, and is exempt from taxation).

<sup>65</sup> *See, e.g., Fuchs v. Rural Electric Convenience Cooperative Inc.*, 858 F.2d 1210 (7th Cir. 1988) (an electric cooperative was deemed analogous to a municipality and did not have to meet the active supervision test because, "[u]nlike private actors who seek to further their own interests and will exploit market factors to reap the highest possible profits, rural electric cooperatives are in some sense 'instrumentalities of the United States'").

<sup>66</sup> *See, e.g., Bankers Insurance Co.*, 137 F.3d at 1293 (political subdivision treatment accorded to an involuntary association of Florida residential property insurers created by Florida law and directed to write policies for citizens unable to obtain property and casualty insurance on the voluntary insurance market); *Consolidated Television Cable Service, Inc. v. City of Frankfort*, 857 F.2d 354 (6th Cir. 1988) (non-profit corporation created by the city to operate a municipally-owned cable TV system); *Ambulance Service of Reno, Inc. v. Nevada Ambulance Services, Inc.*, 819 F.2d 910 (9th Cir. 1987) (a charitable corporation incorporated by direction of the Washoe County District Board of Health to provide emergency ambulance service in the district was deemed to be an instrumentality of the municipalities comprising the district and thus did not have to meet the active supervision test). The *Consolidated TV* decision was based on the following facts: the non-profit corporation was created by the city's Electric and Water Plant Board, its structure and operation were determined by the city through the board, it existed at the pleasure of the board, the city appointed half of its officers, and its contracts with the board stated that the board "is the owner, and has ultimate control, of the television cable system."

In contrast, the Sixth Circuit applied the active supervision requirement to a municipally-affiliated non-profit corporation where each of the factors cited in *Consolidated TV* was missing.



been exempted from the active supervision requirement through application of these criteria.

Some courts have found state-level boards and similar entities with private participants to be exempted from the active supervision requirement where they perform a public function and are directly accountable to the state. In *Earles v. State Bd. of Certified Public Accountants of Louisiana*, for example, the Fifth Circuit deemed the State Board of CPAs of Louisiana to be “functionally similar to a municipality” and therefore not subject to active supervision. The court reasoned: “Despite the fact that the Board is composed entirely of CPAs who compete in the profession they regulate, the public nature of the Board’s actions means that there is little danger of a cozy arrangement to restrict competition.”<sup>67</sup>

Likewise, in *Hass v. Oregon State Bar*, the Ninth Circuit deemed a state bar operating as an instrumentality of the state supreme court to be a state agency and not subject to the active supervision requirement. The court examined the characteristics of the state bar and applied the rationale of *Town of Hallie* with respect to municipalities. “The records of the Bar, like those of other state agencies and municipalities, are open for public inspection. The Bar’s accounts and financial affairs, like those of all state agencies, are subject to periodic audits by the State Auditor. The Board, like the governing body of other state agencies and municipalities, is required to give public notice of its meetings, and such meetings are open to the public. Members of the Board are public officials who must comply with the Code of Ethics enacted by the state legislature to guide the conduct of all public officials. These requirements leave no doubt that the Bar is a public body, akin to a municipality for the purposes of the state action exemption.”<sup>68</sup>

On the other hand, state-level boards and similar entities may be subject to the active supervision requirement if they involve the substantial participation of private actors under

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*See Riverview Investments, Inc. v. Ottawa Community Improvement Corp.*, 899 F.2d 474 (6th Cir. 1990) (nonprofit corporation contractually responsible for reviewing requests for industrial revenue bonds on behalf of the Village of Ottawa, Ohio). Ohio law required that two-fifths of CIC members be elected or appointed officials, but the Village had no involvement in selecting the members. Although the Village could terminate CIC’s existence through an ordinance, the court held that “[t]he abstract, theoretical *power* to terminate CIC’s existence is not a sufficient indication that CIC was *controlled* by the Village.” *Id.* at 480 (emphasis in original).

<sup>67</sup> 139 F.3d at 1041. The Board was created by the state as a part of its Department of Economic Development – an executive branch agency – for the purpose of licensing public accountants and regulating the profession of public accounting within the state, and its members were appointed by and served at the pleasure of the governor.

<sup>68</sup> 883 F.2d at 1460 (internal citations omitted).



circumstances that may be particularly conducive to their pursuing private agendas.<sup>69</sup> In *Washington State Electrical Contractors Ass'n v. Forrest*, for example, the Ninth Circuit reversed and remanded for further consideration the district court's finding that the Washington Apprenticeship Council – an entity created pursuant to the state Apprenticeship Act – was a state agency, and thus not subject to the active supervision requirement, because “The council has both public and private members, and the private members have their own agenda which may or may not be responsive to state labor policy.”<sup>70</sup>

Similarly, in *Federal Trade Commission v. Monahan*, the Massachusetts Board of Registration in Pharmacy was held to be a subordinate governmental unit, but “[w]hether any ‘anticompetitive’ Board activities are ‘essentially’ those of private parties [and thus require active supervision was found to] depend[] upon how the Board functions in practice, and perhaps upon the role played by its members who are private pharmacists.”<sup>71</sup>

### 3. Supervision “By the State Itself”

Although *Midcal* states that the challenged conduct must be supervised “by the State itself,”<sup>72</sup> that statement generally has not been interpreted literally to require supervision by the legislature or the state’s supreme court.<sup>73</sup> The lower courts generally hold that active supervision by a municipality is also sufficient.<sup>74</sup> The Sixth Circuit, however, apparently does not regard

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<sup>69</sup> While the same could perhaps be said of state bars and state boards of CPAs, the Fifth and Ninth Circuits, in *Earles* and *Hass*, found them less likely to be subject to abuse and pursuit of private agendas.

<sup>70</sup> 930 F.2d at 737. This inquiry is closely related to the initial analysis whether a given instrumentality qualifies as “the state itself,” and hence is automatically shielded from antitrust liability. See *supra* Chapter I.B. Even if a particular instrumentality is not “the state itself,” it may be enough like the state that courts will require only clear articulation and not active supervision.

<sup>71</sup> 832 F.2d at 690.

<sup>72</sup> *Midcal*, 445 U.S. at 105 (emphasis added). See also *Patrick*, 486 U.S. at 100; *Town of Hallie*, 471 U.S. at 46 n.10.

<sup>73</sup> See *Areeda & Hovenkamp*, *supra* note 11, at 485 (“Because it was obvious that the Supreme Court was not requiring direct supervision by the state’s supreme court or legislature, supervision by subordinate agencies was necessarily envisaged.”). Justice Rehnquist noted in *City of Boulder* that it would be “rather odd to require municipal ordinances to be enforced by the State rather than the city itself.” 455 U.S. at 71 n.6 (Rehnquist, J., dissenting).

<sup>74</sup> See, e.g., *Tri-State Rubbish v. Waste Management*, 998 F.2d 1073, 1079 (1st Cir. 1993) (“municipal supervision of private actors is adequate where authorized by or implicit in the



municipal supervision to be sufficient to satisfy the active supervision test.<sup>75</sup>

#### 4. Nature of the Required Showing

Supreme Court rulings have established the basic parameters of the supervision requirement. First, the State must "have and *exercise* power to review" the challenged conduct and "exercise ultimate control."<sup>76</sup> Further, the State must exercise "sufficient independent judgment and control" such that "the details of the [restraint] have been established as a product

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state legislation"); *Tom Hudson & Assocs. v. City of Chula Vista*, 746 F.2d 1370 (9th Cir. 1984); *Gold Cross Ambulance & Transfer v. City of Kansas City*, 705 F.2d 1005 (8th Cir. 1983) (it would be "unwise" to require *state* supervision of a municipality's privately owned ambulance service; once state authorization is found, the supervision could come from the municipality).

<sup>75</sup> See *Riverview Investments, Inc. v. Ottawa Community Improvement Corp.*, 774 F.2d 162 (6th Cir. 1985) (The court modified its remand order, in light of *Town of Hallie* and *Southern Motor Carriers*, by directing the district court to take evidence on whether the defendant was actively supervised by "the state." The initial remand order directed the district court to take evidence on whether the defendant was actively supervised by the City of Ottawa), *modifying Riverview Investments, Inc. v. Ottawa Community Improvement Corp.*, 769 F.2d 324 (6th Cir. 1985).

Professors Areeda and Hovenkamp state that "[t]he relevant supervision must generally come from the same level of government that has created the regulatory scheme under consideration – thus, for example, . . . supervision under a municipal waste disposal scheme would generally come from the municipality through a designated agency or official." Areeda & Hovenkamp, *supra* note 11, at 386. Another author argues that supervision by a municipality should not be sufficient to assert a state action defense because there is a significant risk of regulatory capture. Mark A. Perry, *Municipal Supervision and State Action Antitrust Immunity*, 57 U. CHI. L. REV. 1413, 1429-30 (1990). Perry argues that while the efficacy of the democratic process justifies non-application of the active supervision requirement to municipalities, the same does not hold true for private conduct at the local level. Consumers face a collective action problem and information costs, and, therefore, will have less influence than small but powerful interest groups. Therefore, according to Perry, municipal supervision is not a sufficient basis from which to infer that the challenged activity accords with state policy.

The courts, however, have not generally agreed with Perry's capture argument. Professors Areeda and Hovenkamp note that "it would be implausible to rule that a city may regulate, say, taxi rates but only if a state agency also supervises the private taxi operators," citing as support the dissent in *Boulder*. Areeda & Hovenkamp, *supra* note 11, at 486. They further note that the lower courts are generally in agreement on this point. *Id.*

<sup>76</sup> *Patrick*, 486 U.S. at 101 (emphasis added).



of deliberate state intervention, not simply by agreement among private parties.”<sup>77</sup>

The state must supervise not only the general regulatory scheme but also the particular conduct at issue. As stated in *Patrick*, state officials must “have and exercise power to review *particular anticompetitive acts* of private parties and disapprove those that fail to accord with state policy.”<sup>78</sup> Thus, state supervision is not sufficient if it does not reach the conduct that resulted in the alleged harm, even if the state actively supervised other aspects of private conduct.

Active supervision requires actual involvement of the state, as opposed to mere authority to exercise supervisory power. “The mere potential for state supervision is not an adequate substitute for a decision by the State.”<sup>79</sup> The Supreme Court in *Ticor* thus rejected the standard adopted by the Third Circuit, as well as that of the First Circuit in *New England Motor Rate Bureau*,<sup>80</sup> which had held that the existence of a state regulatory program, if staffed, funded, and empowered by law, satisfied the requirement of active supervision.<sup>81</sup> The *Ticor* Court held that a “negative option” form of supervision is not sufficient unless the state has taken steps to inform itself of the details of the proposed private action. Thus, “[w]here prices or rates are set as an initial matter by private parties, subject only to a veto if the State chooses to exercise it, the party claiming the immunity must show that state officials have undertaken the necessary steps to determine the specifics of the price-fixing or ratesetting scheme.”<sup>82</sup> The Court did not totally foreclose the use of negative option supervision, but it rejected the proposition that inaction by

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<sup>77</sup> *Ticor*, 504 U.S. at 634-35.

<sup>78</sup> *Patrick*, 486 U.S. at 101 (emphasis added). Professors Areeda and Hovenkamp interpret *Ticor* in the same manner: “One implication of *Ticor* seems relatively clear. The “supervision” requirement extends not only to the general regulatory scheme, but to particular details, at least when the challenged activity is price fixing. Thus, if a particular practice by a regulated firm is challenged, the regulated firm can claim the *Parker* exception only by showing that the practice at issue was brought to the attention of the regulatory agency, that the agency considered the practice with the requisite degree of attention, and that the agency then approved it.” Areeda & Hovenkamp, *supra* note 11, at 480.

<sup>79</sup> *Ticor*, 504 U.S. at 638.

<sup>80</sup> *New England Motor Rate Bureau, Inc. v. Federal Trade Commission*, 908 F.2d 1064 (1st Cir. 1990).

<sup>81</sup> *See id.* at 1071.

<sup>82</sup> *Ticor*, 504 U.S. at 638. The dissent by Chief Justice Rehnquist pointed out that the Court’s opinion does not make clear “whether this is a separate test applicable only to negative option regulatory schemes, or whether it applies more generally to issues of immunity under the state-action doctrine.” *Id.* at 645 n.5.



the state under a negative option rule signified substantive approval as a matter of law.<sup>83</sup>

The state's supervision must reach the *substantive merits* of the challenged conduct, and the state's involvement must be meaningful. "The mere presence of some state involvement or monitoring does not suffice."<sup>84</sup> In *Patrick*, for example, the Court held that Oregon did not actively supervise a hospital's peer review decisions, where the State Health Division had authority only to review the procedural aspects of hospital peer review programs, not the substantive merits of peer review decisions. In *Ticor* the Court held that a negative option rule did not provide meaningful supervision in fact because "at most the rate filings were checked for mathematical accuracy," and some were unchecked altogether.<sup>85</sup> Likewise, in *Midcal*, the Court found active supervision lacking where the state authorized price-setting and enforced the prices established by private parties, but did not review the reasonableness of the price schedules or review the terms of fair trade contracts.<sup>86</sup> The state also did not monitor market conditions or engage in any "pointed reexamination" of the program.<sup>87</sup>

Active supervision is not present where defendants' actions preclude meaningful review. In *Ticor*, active supervision was not found where rate filings became effective despite the failure of the rate bureau to provide additional requested information, or its failure to provide additional

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<sup>83</sup> *Id.*

<sup>84</sup> *Patrick*, 486 U.S. at 101.

<sup>85</sup> 504 U.S. at 622.

<sup>86</sup> 445 U.S. at 105-06.

<sup>87</sup> *Id.* at 106. See also *324 Liquor Corp.*, 479 U.S. at 345; *Miller v. Oregon Liquor Control Commission*, 688 F.2d 1222 (9th Cir. 1982) (where regulation allows private parties to establish prices, active supervision requires review for reasonableness of prices), *subsequently withdrawn and then re-filed with order in Miller v. Hedlund*, 813 F.2d 1344 (9th Cir. 1987). While cases such as *Midcal* and *324 Liquor Corp.* appear to leave open the possibility that the active supervision requirement may be met through state monitoring of market conditions, the monitoring must enable the state to exercise significant control over market behavior. In *324 Liquor Corp.*, state law required wholesalers to post their wholesale prices, although wholesalers were permitted to sell below their posted price, and prohibited retailers from selling below "cost," which was defined as the posted wholesale price plus 12%. Although the State Liquor Authority could respond to market conditions by permitting individual wholesalers to depart from their posted prices and by permitting individual retailers to sell below the statutory definition of cost "for good cause shown," and although the state legislature frequently considered proposals to alter the liquor-pricing system, the Court held this insufficient to constitute active supervision. "Neither the 'monitoring' by the SLA, nor the periodic reexaminations by the state legislature, exerts any significant control over retail liquor prices or markups." 479 U.S. at 345.



information in a timely manner.<sup>88</sup> Following *Ticor*, lower courts have held that withholding of key information from a regulatory commission may preclude a finding of active supervision.<sup>89</sup>

The Supreme Court has declined to prescribe a particular form of supervision: "We do not imply that some particular form of state or local regulation is required to achieve ends other than the establishment of uniform prices."<sup>90</sup> Professors Areeda and Hovenkamp suggest that procedural adequacy alone would not be sufficient to constitute active supervision because "*Patrick* . . . requires 'active supervision' in the sense of government review of specific decisions of private parties on their substantive merits, not merely on their procedural adequacy."<sup>91</sup> *Ticor* suggests that the degree of required supervision may depend on the gravity of the antitrust offense.<sup>92</sup> It also suggests that the kind of supervision required may depend on the nature of the regulatory scheme and the degree of authority conferred upon private actors.<sup>93</sup>

It is unsettled whether judicial review by a state court satisfies the active supervision requirement. Without expressly deciding whether judicial review can satisfy the requirement under other circumstances, the Supreme Court has held that the availability of judicial review

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<sup>88</sup> 504 U.S. at 638.

<sup>89</sup> *Cost Management Services, Inc. v. Washington Natural Gas Co.*, 99 F.3d 937 (9th Cir. 1996); *Ticor Title Ins. Co. v. Federal Trade Commission*, 998 F.2d 1129 (3d Cir. 1993) (on remand from Supreme Court).

<sup>90</sup> *Ticor*, 504 U.S. at 639.

<sup>91</sup> Areeda & Hovenkamp, *supra* note 11, at 469.

<sup>92</sup> 504 U.S. at 639 ("Our decision should be read in light of the gravity of the antitrust offense, the involvement of private actors throughout, and the clear absence of state supervision.").

<sup>93</sup> *Id.* at 640 ("we do not here call into question a regulatory regime in which sampling techniques or a specified rate of return allow state regulators to provide comprehensive supervision without complete control"). See also *324 Liquor Corp.*, 479 U.S. at 344 n.6 (dictum) (a statute specifying the margin between wholesale and retail prices may satisfy the active supervision requirement) (citing *Morgan v. Division of Liquor Control, Conn. Dep't of Business Regulation*, 664 F.2d 353 (2d Cir. 1982) (upholding a simple markup statute)); *Municipal Utilities Bd. of Albertville v. Alabama Power Co.*, 934 F.2d 1493 (11th Cir. 1991) (little supervision is required where the state regulatory scheme permits little discretionary behavior by private parties); Areeda & Hovenkamp, *supra* note 11, at 386 ("Private conduct needs supervision only if there is something to be supervised – for example, if a state statute specifies unambiguous service areas for state utilities, future sign-ups of customers within those areas do not require ongoing supervision because the statute leaves the firms without any discretion.").



does *not* constitute active supervision if the court cannot reach the merits of the private action.<sup>94</sup> Circuit court decisions likewise indicate that if state court review is to constitute active supervision, the court must have jurisdiction to review the specific conduct at issue,<sup>95</sup> and the review must be substantive.<sup>96</sup>

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<sup>94</sup> In *Patrick* it was not clear that Oregon law afforded any direct judicial review of private peer review decisions, and the Oregon courts had indicated that even if they were to provide judicial review, the review would be of a very limited nature, focusing on whether adequate procedures were followed and whether sufficient evidence supported the challenged action. The Supreme Court held that such review was insufficient to satisfy the state action requirement because it did not reach “the merits of a privilege termination decision to determine whether it accorded with state regulatory policy.” 486 U.S. at 105. In *Ticor* the Court held that the availability of judicial review did not satisfy the supervision requirement where, “[b]ecause of the state agencies’ limited role and participation, state judicial review was likewise limited.” 504 U.S. at 638.

<sup>95</sup> *Snake River Valley Electric Ass’n v. PacifiCorp*, 238 F.3d 1189 (9th Cir. 2001).

<sup>96</sup> *Shahawy v. Harrison*, 875 F.2d 1529 (11th Cir. 1989) (in the physician peer review context, *Patrick* requires a substantive review and, therefore, a state court review of a private board’s decisions for procedural error and sufficiency of evidence does not constitute active supervision). See also *Pinhas v. Summit Health, Ltd.*, 894 F.2d 1024 (9th Cir. 1990) (scope of review in traditional mandamus proceedings, which is “limited to an examination of the record of hospital proceedings to determine whether the action taken was substantively irrational, unlawful or contrary to established public policy or procedurally unfair,” was too limited to satisfy the active supervision requirement because “a court may not substitute a judgment for that of the governing board even if it disagrees with the board’s decision”).



## CHAPTER II

### RECURRENT PROBLEMS IN THE CASE LAW

In the years since *Parker v. Brown*, the state action doctrine has come to pose a serious impediment to achieving national competition policy goals. As the American Bar Association's Section of Antitrust Law recently stated, "State action immunity drives a large hole in the framework of the nation's competition laws."<sup>97</sup> This chapter identifies aspects of the case law that have proved particularly problematic. Some problem areas reflect court of appeals interpretations of issues left murky by the Supreme Court. Others reflect doctrinal failings that Supreme Court jurisprudence has allowed to persist. In each case, the efficiency goals of the antitrust laws have been sacrificed in ways not required by principles of federalism.

#### A. Clear Articulation: Lost Moorings to State Policy to Displace Competition

Some lower courts have implemented the clear articulation standard in a manner not consistent with its underlying goals. Results have proven most problematic when the courts have lost sight of this touchstone, focusing instead on intermediate inquiries, such as the actor's authority under state law or the presence of a general regulatory scheme, rather than ascertaining whether anticompetitive conduct is the product of a deliberate and intended state policy to displace competition. In such circumstances, the analysis may lose its moorings and reach results inconsistent with the clear articulation standard's ultimate goals.

As explained in Chapter I, the clear articulation standard is designed to help identify conduct that warrants shelter from the antitrust laws on grounds of federalism. It is "directed at ensuring that particular anticompetitive mechanisms operate because of a deliberate and intended state policy,"<sup>98</sup> and "ensures that the strong national policy embodied in the antitrust law will not be set aside where not intended by the state."<sup>99</sup> This is accomplished by asking whether the state as sovereign intends to displace competition in a particular field.<sup>100</sup> The inquiry has been variously described as requiring clear articulation and affirmative expression,<sup>101</sup> clear "intent to

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<sup>97</sup> American Bar Association Section of Antitrust Law, *The State of Antitrust Enforcement - 2001*, Report of the Task Force on the Federal Antitrust Agencies - 2001, 42 (2001) ("ABA Antitrust Section Report"), available at <[http://www.abanet.org/antitrust/antitrust\\_enforcement.pdf](http://www.abanet.org/antitrust/antitrust_enforcement.pdf)>.

<sup>98</sup> *Ticor*, 504 U.S. at 636.

<sup>99</sup> Areeda & Hovenkamp, *supra* note 11, at 374.

<sup>100</sup> *Southern Motor Carriers*, 471 U.S. at 64.

<sup>101</sup> *Midcal*, 445 U.S. at 97.



establish an anticompetitive regulatory program,"<sup>102</sup> a "state policy to displace competition with regulation or monopoly public service,"<sup>103</sup> an "authorized implementation of state policy,"<sup>104</sup> and a showing that the legislature had "contemplated the kind of action complained of."<sup>105</sup>

The Court has suggested a variety of tools for conducting this inquiry. Some of its more recent cases speak in terms of "foreseeability" of anticompetitive effects.<sup>106</sup> Others look for the presence of a regulatory scheme in the affected industry.<sup>107</sup> The tools are useful means for inquiring about state policy to displace competition. Some lower courts, however, have treated these tools as ends in themselves, reasoning, for example, that once action is broadly authorized, any anticompetitive effects flowing from that action must have been foreseeable, but never inquiring whether the state actually intended to displace competition. Other opinions jump from the presence of a regulatory scheme in an industry to the conclusion that all anticompetitive conduct in that industry must be shielded, without ever asking whether there was a basis in state policy for the "particular anticompetitive mechanisms" at issue.

This section illustrates these pitfalls and stresses the need to restore clear articulation's mooring to a state policy to displace competition.

### 1. Confusing Authority with Policy

One recurring problem involves the failure to distinguish between authorizing classes of activity and forming state policy to displace competition. If the two are conflated, activities may be shielded from the antitrust laws without the state's ever intending to displace competition. Such conflation can easily result from misplaced reliance on "foreseeability." Once conduct is authorized, anticompetitive forms of that conduct arguably are foreseeable in the sense that they *could* occur. Yet something more is needed when the goal is to ensure that the anticompetitive conduct flows from "a deliberate and intended state policy."<sup>108</sup> If the analysis stops with a finding of authority, conduct that the legislature never intended to free from competition may be shielded. To avoid this result, the analysis must circle back to the original touchstone – a clear state policy toward displacing competition.

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<sup>102</sup> *Southern Motor Carriers*, 471 U.S. at 65.

<sup>103</sup> *Town of Hallie*, 471 U.S. at 39 (quoting *City of Lafayette*, 435 U.S. at 413).

<sup>104</sup> *Omni*, 499 U.S. at 370.

<sup>105</sup> *Town of Hallie*, 471 U.S. at 44.

<sup>106</sup> *See Omni*, 499 U.S. at 373; *Town of Hallie*, 471 U.S. at 42-43.

<sup>107</sup> *See Southern Motor Carriers*, 471 U.S. at 63-65.

<sup>108</sup> *Ticor*, 504 U.S. at 636.



An extreme example highlights the problem. State corporation laws typically authorize corporate entities to merge or to acquire property.<sup>109</sup> Under such a law, it is foreseeable, indeed likely, that some mergers and acquisitions will be in the same relevant market as a corporation's current operations and will raise competition concerns. If that foreseeability suffices to invoke a state action defense, the nation's merger review laws will have been almost entirely overridden. Of course, that is not the case. The state never intended to displace competition in this manner by its general corporation laws. Yet analysis that treats foreseeability as the end point rather than as an intermediate tool for determining state policy toward displacing competition could give exactly those wrong results.

Several recent appellate cases follow this overbroad analysis.<sup>110</sup> For example:

- *Bankers Insurance Co. v. Florida Residential Property & Casualty Joint Underwriting Ass'n*<sup>111</sup> equated broad, unfettered authority with clear articulation. The defendant was an involuntary association of residential property insurers formed by Florida's legislature in the wake of Hurricane Andrew to write insurance policies for citizens otherwise unable to obtain property and casualty insurance. Plaintiff, a Florida insurer that had lost a competitive bid for servicing the association's policies, claimed that the association had violated § 1 of the Sherman Act by anticompetitively revising its bidding standards in mid-review. The court observed that the underlying statute stated that the association "[m]ay provide for one or more designated insurers . . . to act on behalf of the association to provide such service," and found that the association was therefore "freely

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<sup>109</sup> See, e.g., 805 Ill. Compiled Stat. Ann. § 5/11.05 ("Any 2 or more corporations may merge into one of such corporations or consolidate into a new corporation"); 805 Ill. Compiled Stat. Ann. § 5/305(d) (authorizing corporations to "purchase . . . any real or personal property") or § 5/305(g) (authorizing corporations to "purchase . . . shares or other interests in, or obligations of, other domestic or foreign corporations, associations, partnerships, or individuals").

<sup>110</sup> See Floyd, *supra* note 11, at 1076 ("As the *Hallie* 'foreseeability' test has been applied by the courts of appeals, it has proven to have essentially no bite, leading to the conclusion that the broader the delegation of authority to act with respect to a particular subject matter, the more likely that anticompetitive conduct will be held to be the foreseeable result of that delegation."). Floyd asks "why, if a clear articulation of state policy is required to ensure that the actions of non-sovereign units of local government are in accordance with that policy, the requirement should be interpreted in a way that makes it impossible for it to achieve that goal." *Id.* at 1077.

<sup>111</sup> 137 F.3d 1293 (11th Cir. 1998).



permitted” to provide for policy service “as it sees fit – or not to contract at all.”<sup>112</sup> The court concluded: “It is foreseeable that conferring such unfettered discretion on the Association to select policy servicing services could result in potentially anticompetitive adjustment and revision of standards and selection criteria.”<sup>113</sup> In other words, the bare fact that the association was authorized to enter service contracts if it wished was treated as clear articulation sufficient to override the nation’s antitrust laws.

- *Sterling Beef Co. v. City of Fort Morgan*<sup>114</sup> found that a statute that granted municipalities the power to acquire gas distribution systems expressed a state policy to displace competition with regulation in the market for the provision of natural gas. The court ruled that the state action doctrine sheltered a city’s refusal to allow its largest gas customer to build a pipeline on its own property to link to an external source. Noting that the statute permitting municipalities to acquire or build gasworks and gas distribution systems did not prescribe the number of systems and permitted the city to condemn existing utility works, the court found that the statutory framework detailed “all the powers necessary to permit the city to attain a monopolistic position as to gas distribution” and declared the anticompetitive impact an “obvious result of the state scheme.”<sup>115</sup> Thus, bare authorization to make acquisitions that imaginably could have anticompetitive effects was treated as clear articulation of a policy to shut out competition.
- *Independent Taxicab Drivers’ Employees v. Greater Houston Transportation Co.*<sup>116</sup> found that the state action defense shielded the City of Houston’s decision to enter into an exclusive contract with Yellow Cab for service at its airport. Clear articulation was premised on a state statute authorizing the city to enter, and establish the terms and conditions of, contracts governing services at the airport: “the statute’s broad phrasing is a strong indication of the state’s desire to abdicate

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<sup>112</sup> *Id.* at 1298 (emphasis added). The statute also required the association to abide by its licensed agents’ preferences in assigning servicing agents, unless the association has “reason to believe” it is in its best interest to make a different assignment. Although the court cited this provision for other purposes, it did not rely on it in rejecting the challenge to the revised bidding procedures. *Id.*

<sup>113</sup> *Id.* at 1298.

<sup>114</sup> 810 F.2d 961 (10th Cir. 1987).

<sup>115</sup> *Id.* at 964.

<sup>116</sup> 760 F.2d 607 (5th Cir. 1985).



in favor of municipal prescience with regard to airport management.”<sup>117</sup> The court found that the city “might deem it most efficient” to enter an exclusive contract and termed such a decision “a logical or reasonable consequence of the state’s broad allocation of authority.”<sup>118</sup> It held: “where a state has to this extent articulated a policy of regulatory deference to its municipalities, and where a city has not unreasonably exercised its authority, the city’s actions are not subject to the constraints of federal antitrust law.”<sup>119</sup> Consequently, authorization to contract became viewed as a policy choice to permit anticompetitive contracts.

An analytical approach premised on mere authority to act, rather than on a state policy to displace competition, misconstrues the state action doctrine. It is fundamentally inconsistent with at least two Supreme Court opinions. *Boulder* rejected claims that a broad, constitutional home rule provision clearly articulated the intention to displace competition necessary to shield a moratorium on cable television expansions:

“Acceptance of such a proposition – that the general grant of power to enact ordinances necessarily implies state authorization to enact specific anticompetitive ordinances – would wholly eviscerate the concepts of “clear articulation and affirmative expression” that our precedents require.”<sup>120</sup>

As the Court elaborated in *Omni*:

“Besides authority to regulate, however, the *Parker* defense also requires authority to suppress competition – more specifically, “clear articulation of a state policy to authorize

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<sup>117</sup> *Id.* at 610. The court also relied on a statute permitting municipalities to regulate taxi rates as an independent ground for its conclusions. *Id.* at 611.

<sup>118</sup> *Id.* at 611.

<sup>119</sup> *Id.* See also *Martin v. Memorial Hospital at Gulfport*, 86 F.3d 1391 (5th Cir. 1996), where a physician challenged a hospital’s exclusive contract for operating a kidney dialysis facility. The court held that statutes satisfied the clear articulation standard where they: (i) authorized a hospital owned by a municipality and a state subdivision hospital district to contract with any individual for the provision of services; and (ii) required a certificate of need before establishing a health care facility. The allegedly anticompetitive conduct could have been reasonably anticipated when the legislature conferred the power to contract with an individual physician, and the CON program necessarily restricts entry. *Id.* at 1400. Hence, the court reasoned, the allegedly anticompetitive results were foreseeable. *Id.* This example demonstrates the tendency of some courts to conflate general authority with a clear articulation of intent to displace competition, thus lowering the bar for assertion of a state action defense substantially.

<sup>120</sup> 455 U.S. at 56.



anticompetitive conduct” by the municipality in connection with its regulation.”<sup>121</sup>

The necessary bridge between the city’s authority to regulate – in *Omni*, “its unquestioned zoning power over the size, location and spacing of billboards”<sup>122</sup> – and the conclusion that “suppression of competition is ‘the foreseeable result’ of what the statute authorizes”<sup>123</sup> is a concrete basis for concluding that the state intended to displace competition. That basis may be readily found when it is inherent in the specific statutes relied upon,<sup>124</sup> but to find it in general statutes authorizing normal business conduct makes the standard one of imaginable consequences rather than “deliberate and intended” policy.

All this has been recognized by some court of appeals cases.<sup>125</sup> For example, the Fifth Circuit recently issued an *en banc* opinion to clear up confusion in that circuit between grants of authority and the necessary intention to displace competition. In *Surgical Care Center of Hammond v. Hospital Service District No. 1*,<sup>126</sup> it held that statutes authorizing a hospital district to enter contracts and to participate in joint ventures failed to shield exclusive contracts that prohibited managed care plans from using a competitor for outpatient surgical care. The court rejected arguments that statutes conferring basic corporate powers on local units of government satisfy the state action doctrine.<sup>127</sup> It distinguished “a statute that, in empowering a municipality,

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<sup>121</sup> 499 U.S. at 372.

<sup>122</sup> *Id.*

<sup>123</sup> *Id.* at 365.

<sup>124</sup> That basis was apparent in *Omni* from the nature of zoning regulation: “*The very purpose of zoning regulation is to displace unfettered business freedom in a manner that regularly has the effect of preventing normal acts of competition, particularly on the part of new entrants.*” *Id.* at 373 (emphasis added). Similarly, the Court in *Town of Hallie* reasoned when a statute specifically authorized a city “to provide sewage services and *also to determine the areas to be served,*” anticompetitive effects from refusing to serve certain areas “logically would result.” 471 U.S. at 42 (emphasis added).

<sup>125</sup> Judge Posner frames the issue well: “Permission is not policy unless the state has a definite intention as to how the permission will be exercised.” *Hardy v. City Optical, Inc.*, 39 F.3d 765, 768 (7th Cir. 1994).

<sup>126</sup> 171 F.3d 231 (5th Cir. 1999).

<sup>127</sup> The court distinguished *Martin* on the ground that clear articulation in that case flowed from the combination of an enabling statute, which conferred basic corporate powers, *and* a certificate of need. In doing so, the court explicitly rejected the district court’s broader reading, stating that “[t]he district court here read *Martin* to find *Parker* immunity from the enabling statute alone . . . . That reading, as we have explained, is no longer valid, if it ever was.”



necessarily contemplates the anticompetitive activity from one that merely allows a municipality to do what other businesses can do,"<sup>128</sup> finding that to infer a policy to displace competition from authority to enter joint ventures would "stand federalism on its head."<sup>129</sup> The appropriate inquiry is whether "it is clear from the nature of the policy articulated that the state contemplates such a displacement of competition,"<sup>130</sup> and whether "language and context fairly locate a state policy to displace competition."<sup>131</sup>

Similarly, the Ninth Circuit in *Lancaster Community Hospital v. Antelope Valley Hospital District*<sup>132</sup> gave primacy to displacement of competition and refused to find it from mere authorization to engage in business. Rejecting arguments that a hospital's broad authority to provide hospital services in and of itself established authority to exclude others, the court found that the state had not displaced competition with regulation in the provision of hospital services. The court applied a two-step analysis, asking, first, whether the activity complained of is authorized, and then separately inquiring whether the state intends to displace competition with regulation.<sup>133</sup> It reasoned that under *Town of Hallie* "the courts are to focus on whether the state's policy is to supplant or support competition in the area of dispute, albeit paying particular attention to the foreseeable or logical consequences of a state's grant to a delegate of broad authority."<sup>134</sup> It concluded that authorizing the defendants to provide hospital services along with all other competitors conferred no power to regulate the hospital services market and should not readily be viewed as a displacement of competition.<sup>135</sup>

Leading antitrust commentators make the same points. Thus the Areeda and Hovenkamp treatise identifies an intent to displace the antitrust laws as a necessary element of a state action

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*Hammond*, 171 F.3d at 236.

<sup>128</sup> *Hammond*, 171 F.3d at 235.

<sup>129</sup> *Id.* at 236.

<sup>130</sup> *Id.* at 234.

<sup>131</sup> *Id.* at 236.

<sup>132</sup> 940 F.2d 397 (9th Cir. 1991).

<sup>133</sup> *Id.* at 400 n.4.

<sup>134</sup> *Id.* at 401.

<sup>135</sup> *Id.* at 402-03. In holding that a state action defense was unavailable, the court also stressed that there were "abundant indications" that the state had committed itself to a competitive market. *Id.* at 403-04.



defense, separate from state authorization of the challenged activity.<sup>136</sup> “We would therefore disagree . . . with decisions holding or suggesting that the power to buy and sell property implies the power to enter into otherwise unlawful mergers . . . or that the bare power to make contracts implies the power to enter into anticompetitive exclusive arrangements.”<sup>137</sup> Professor Page reasons that “only considered state policies are sufficient to trigger the concerns of state autonomy”,<sup>138</sup> that the clear articulation standard is the mechanism used “[t]o distinguish considered state policies from others”;<sup>139</sup> and that “[t]he degree of clarity required is determined . . . by the ultimate issue of whether it is apparent from the statute that the legislature actually made the decision to adopt the regulatory policy that is assertedly in conflict with antitrust laws.”<sup>140</sup> Professor Floyd argues that the “foreseeability” standard “as it has developed in the lower courts under *Town of Hallie* is subject to substantial criticism” and concludes that “much can be said in the cases involving municipal and private actors for attempts by the Federal Trade Commission and the Department of Justice to introduce a greater degree of rigor to the clear articulation inquiry.”<sup>141</sup>

Finally, there is need to ensure that consideration of state competition policies be as meaningful in practice as in principle. *Federal Trade Commission v. Hospital Bd. of Directors of Lee County*<sup>142</sup> highlights this concern. It dealt with an acquisition by a county hospital board of a second, privately-owned hospital. The court found clear articulation in a statute that authorized the Board to “establish and provide for the operation and maintenance of additional hospitals; satellite hospitals; clinics; or other facilities devoted to the provision of healthcare” and to “participate in or control any venture, corporation, partnership or other organization” operated for “purposes consistent with” and in furtherance of the “best interests of the hospital and other facilities created and authorized under this act.”<sup>143</sup> Although the court nominally recognized that clear articulation requires not just authorization of the challenged activity but also a state policy

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<sup>136</sup> Areeda & Hovenkamp, *supra* note 11, at 437.

<sup>137</sup> *Id.* at 455.

<sup>138</sup> William H. Page, *Capture, Clear Articulation, and Legitimacy: A Reply to Professor Wiley*, 61 S. CAL. L. REV. 1343, 1345 (1988).

<sup>139</sup> *Id.*

<sup>140</sup> Page, *supra* note 138, at 642.

<sup>141</sup> Floyd, *supra* note 11, at 1083. *But see* Jorde, *supra* note 19, at 247-48 (concluding that the Supreme Court’s clear articulation decisions strike an appropriate balance between antitrust and economic federalism values).

<sup>142</sup> 38 F.3d 1184 (11th Cir. 1994).

<sup>143</sup> *Id.* at 1186.



authorizing anticompetitive conduct,<sup>144</sup> its actual analysis conflated the inquiries.

The court looked to the context in which the general authorizing language was enacted. It found that when the Board was created there was only one hospital in the county, and that when the underlying statute was amended to permit the Board to add new facilities, there was overcapacity, so that market conditions would not have justified a certificate of need to build new facilities. Under these conditions, acquisition of a competing hospital was deemed "reasonably anticipated" and hence foreseeable.<sup>145</sup> But no true inquiry into intention to displace competition was made. There was no showing that the legislature knew of local overcapacity or had contemplated the likely results of any certificate of need adjudication. There was no indication that the legislature might not have contemplated acquisition of a small facility or of facilities devoted to complementary practice areas and therefore less likely to raise competition concerns. There was no suggestion that the legislature had contemplated that any authorized acquisition was likely to have anticompetitive effects, a conclusion that generally entails extensive and painstaking analysis of marketplace conditions.<sup>146</sup> In sum, the deliberate intention to displace competition was nowhere manifested by the state, but rather created by suppositions of the court.

In light of the problems that have emerged in many of the court of appeals interpretations, there is clear need to develop a legal framework to distinguish situations in which states intended to displace competition and supplant the antitrust laws from those in which they did not. The focus of inquiry should shift from mere authorization toward the substance of the state's policy regarding competition, and inquiry should be pointed and deliberate.

The inquiry should also account for the fact that "foreseeability" is a matter of degree. In whatever state statute is being examined, the likelihood of an anticompetitive outcome can be expressed in terms of a degree of risk. That degree of risk, in turn, affects what the legislature can be understood to have actually foreseen. Where the exercise of a particular power will ordinarily or routinely result in anticompetitive effects, the anticompetitive effects are present

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<sup>144</sup> *Id.* at 1188.

<sup>145</sup> *Id.* at 1192. The court rejected the Commission's argument that a foreseeable anticompetitive effect is one that ordinarily or routinely occurs or is inherently likely to occur. Instead, it ruled that "a foreseeable anticompetitive effect is one that can reasonably be anticipated to result from the powers granted to a political subdivision by the state." *Id.* at 1190-91.

<sup>146</sup> As Professors Areeda and Hovenkamp explain: "[T]he power to contract certainly implies the power to enter into exclusive provider agreements, because the great majority of such agreements are lawful. But one would not assume without additional clarification that such authority included the power to enter into the occasionally unlawful agreement." Areeda & Hovenkamp, *supra* note 11, at 455. The same thinking applies with equal force to the analysis of acquisitions.



with a high degree of likelihood, and the legislature may fairly be said to have intended to authorize them.<sup>147</sup> Conversely, where the exercise of a power will produce anticompetitive effects only under idiosyncratic or unlikely circumstances, the effects are present only with a low degree of likelihood, and the legislature can fairly be said not to have authorized them. Assigning a probability to the events is therefore the key to deciding whether the “foreseeability” defense is properly available.

## 2. Broad Regulatory Regimes

A second recurring fact pattern arises when the state has adopted a regulatory program affecting a given industry. Just as general authority to engage in business activities sometimes has been mistaken for an intention to displace competition with regard to all authorized conduct, the presence of a general regulatory regime in an industry has led some courts automatically to find displacement of all aspects of competition in that industry. The result has been to override national competition policy even when states never expressed a clear intention to do so.

Again, some examples illustrate the problem:

- *Sandy River Nursing Care v. Aetna Casualty*<sup>148</sup> recognized a state action defense when a statute regulating workers’ compensation insurance rates authorized joint rate filings but stipulated that the approved rates were *upper limits* on permissible charges. Plaintiffs alleged that insurers had agreed not to charge *less than* the approved maximum rate. The court ruled that the statute implicitly condoned that agreement: “we fail to see how it could be illegal price fixing . . . to agree to charge the rates allowed by the state.”<sup>149</sup> Noting that a “uniform approach to ratemaking” was the overriding characteristic of the program and that the state regulator was to establish just and reasonable rates, the court stated that “the expectation clearly is that the Superintendent’s rates are the ones that generally will be appropriate for, and thus used by all insurers.”<sup>150</sup> Yet the court never truly confronted the fact that in providing that the approved rates were *upper limits* on permissible charges, the legislature never expressed a clear intention to permit insurers to act collectively to *fix* their rates at that level.

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<sup>147</sup> This is the foreseeability standard that the Commission proposed in *Lee Memorial Hospital*. See 38 F.3d at 1188 (“The Commission contends that a foreseeable anticompetitive effect is one that ordinarily occurs, routinely occurs, or is inherently likely to occur as a result of the empowering legislation.”).

<sup>148</sup> 985 F.2d 1138 (1st Cir. 1993).

<sup>149</sup> *Id.* at 1146.

<sup>150</sup> *Id.*



- In *Earles v. State Board of Certified Public Accountants* a statute authorized a state board (comprised of private CPAs) to “adopt and enforce all . . . rules of professional conduct . . . as the board may deem necessary and proper to regulate the practice of public accounting in the state of Louisiana”<sup>151</sup> Pursuant to this authority the board barred CPAs from participating in other businesses or occupations that impair their independence or objectivity and prohibited licensees from accepting commissions for referring the products of others to a client. The board interpreted its rules to bar persons acting as securities brokers from serving as CPAs. The court reasoned that the state conferred “a broad grant of authority which includes the power to adopt rules that may have anticompetitive effects” and intended that the Board exercise any power authorized, so that the fact that the Board may actually have promulgated a rule with anticompetitive effects was “reasonably foreseeable.”<sup>152</sup> By establishing a broad regulatory regime and establishing a “permissive” policy with respect to the Board’s activities, the court reasoned, the legislature had “rejected pure competition among public accountants” and inevitably condoned anticompetitive effects.<sup>153</sup> No inquiry was made as to whether the state actually intended to displace competition in the manner at issue.

Other appellate decisions have insisted on a more searching inquiry into whether the legislature truly intended to displace competition in the manner at issue. For example, Judge Posner’s opinion in *Hardy v. City Optical* rejected the state action defense in a setting where the general regulatory scheme did not supplant the form of competition at issue. In that case a statute required optometrists to provide patients with some, but not all, of the information needed to purchase contact lenses. As a result, when an optometry chain denied access to the complete prescriptions, its patients were unable to purchase their lenses through cheaper, mail-order sources. The court ruled that forbidding the conduct under the antitrust laws would not impair the “state’s regulatory objectives,” and concluded that “Indiana has not sought to supplant the form of competition – competition from mail-order houses . . . that the complaint charges the defendants with attempting to suppress.”<sup>154</sup>

Employing similarly careful analysis, *Yeager’s Fuel, Inc. v. Pennsylvania Power & Light Co.*<sup>155</sup> found clear articulation in a setting where oil dealers challenged an electric utility’s incentive rates and cash grants for subsidizing installation of heat pumps. Rather than resting the

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<sup>151</sup> 139 F.3d 1033, 1042 (5th Cir. 1998).

<sup>152</sup> *Id.* at 1043.

<sup>153</sup> *Id.* at 1044.

<sup>154</sup> 39 F.3d at 769.

<sup>155</sup> 22 F.3d 1260 (3d Cir. 1994).



analysis on the presence of a general scheme of electricity regulation, the court reasoned that a state policy in favor of energy conservation and load management that expressly authorized loans and rebates for energy-saving systems could easily be foreseen to provide one company with an advantage over another, resulting in anticompetitive effects.<sup>156</sup>

Other cases have rejected clear articulation claims in contexts where conduct exceeded the specific bounds of regulatory authorizations. In *Cost Management Services, Inc. v. Washington Natural Gas Co.*,<sup>157</sup> for example, the court refused to shield a natural gas utility's alleged predatory pricing because it fell below tariff levels and consequently may have violated state law. "[T]he fact that Washington may have displaced competition in the market for sale of natural gas is not dispositive," the court reasoned.<sup>158</sup> "Rather, the relevant question is whether the regulatory structure which has been adopted by the state has specifically authorized the conduct alleged to violate the Sherman Act."<sup>159</sup> *Columbia Steel Casting Co. v. Portland General Electric Co.*<sup>160</sup> adds the proposition that when a state's regulatory statutes authorize market allocations among electric utilities *if* approved in a particular case by a regulatory commission, there is no clear articulation of a policy to displace competition absent the commission's specific approval. The opinion rejected claims that clear articulation could be found from the encouragement of market allocation that allegedly was inherent in the statutory scheme.<sup>161</sup>

In sum, the goal of the clear articulation analysis should be to determine whether in the case at hand the state has deliberately adopted a policy to displace competition so as to justify supplanting the antitrust laws. Sometimes this may be evident from the general regulatory scheme. On other occasions a more detailed look may be needed. When the inquiry is cut short before it can provide a sound answer as to the state's intentions, there is danger of unwarranted sacrifice of the national interest in a competitive marketplace.

## B. Active Supervision

### 1. What Constitutes Active Supervision

The basic tests for active supervision articulated in *Midcal*, *Patrick*, and *Ticor*, while appropriate to the stated purpose and appropriate in the context of the conduct at issue in those

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<sup>156</sup> *Id.* at 1267-68.

<sup>157</sup> 99 F.3d 937 (9th Cir. 1996).

<sup>158</sup> *Id.* at 942.

<sup>159</sup> *Id.*

<sup>160</sup> 111 F.3d 1427 (9th Cir. 1996).

<sup>161</sup> *Id.* at 1437 n.8.



cases, are lacking in specific guidance on how states should conduct their supervision to satisfy the ultimate requirement of “active” supervision. The cases require the reviewing official to engage in a “pointed reexamination” of a state-authorized price-setting program (*Midcal*), review the “reasonableness” of prices and contractual terms (*Midcal*), reach the “substantive merits” of peer review decisions (*Patrick*), determine whether the private action “accorded with state regulatory policy” (*Patrick*), and exercise “sufficient independent judgment and control” to ensure that “the details of the rates or prices have been established as a product of deliberate state intervention” (*Ticor*). Apart from these general directives, however, the cases do not provide much specific guidance on what kind of state review would constitute “active” supervision, in terms of either the kind of scrutiny required by the state official or procedural requirements.<sup>162</sup> Nor do the cases provide specific guidance on the kind of scrutiny appropriate to federal court review of state action. These gaps in the law pose a risk of inconsistency and inadequacy of review, both in state supervision and in antitrust review.

## 2. Identification of Entities Subject to Active Supervision

There are shortcomings in some lower court decisions with respect to the identification of entities that should be subject to the active supervision requirement. While it is clear that purely private actors are subject to the requirement, and municipalities and other political subdivisions are not, there is a gray area consisting of hybrid state or local entities with a combination of some governmental characteristics and the active participation of private actors, such as regulatory boards and special purpose authorities (*e.g.*, hospital and airport authorities). Application of the active supervision requirement to these entities is determined case-by-case, based on an examination of the public/private characteristics of the entity. That examination is not always as rigorous as it might be.

The general test to determine whether active supervision is required examines “whether the nexus between the State and the [entity in question] is sufficiently strong that there is little real danger that the [entity] is involved in a *private* price-fixing arrangement.”<sup>163</sup>

The criteria applied by the courts are not entirely probative, however. In *Valdosta*, the Eleventh Circuit considered two factors when determining the status of a hospital authority created under Georgia law. First, the state had chosen to operate its hospitals through the instrumentality of hospital authorities and had clothed these entities with certain – though not complete – governmental qualities and powers, including the right to use eminent domain, to receive proceeds from the sale of general obligation or county bonds, and to issue revenue anticipation certificates or other evidence of indebtedness. Second, the legislature deemed the

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<sup>162</sup> As earlier noted, the Court in *Ticor* declined to impose specific procedural requirements for the state’s review. *See supra* Chapter I.D.4.

<sup>163</sup> *Crosby v. Hospital Auth. of Valdosta*, 93 F.3d at 1524 (citing *Town of Hallie*) (emphasis in original).



authorities to be “public bodies” which exercise “public and essential governmental functions.” Although hospital authorities also were empowered “to act as market participants in several respects by granting them several powers which resemble those of a private corporation,” the Eleventh Circuit held that “[t]he mere grant of such powers . . . does not transform an otherwise governmental entity into a private actor of the type we would expect to engage in a private price-fixing agreement.” The court concluded that “[n]one of [the authority’s] non-governmental aspects create a danger that it is involved in a private price-fixing arrangement.”<sup>164</sup>

A more recent Eleventh Circuit case recited a more expansive list of factors favoring political-subdivision treatment: “open records, tax exemption, exercise of governmental functions, lack of possibility of private profit, and the composition of the entity’s decisionmaking structure.”<sup>165</sup> Some courts also stress that the public nature of a group’s activities obviates concerns about anticompetitive conduct.<sup>166</sup>

The governmental attributes of a hybrid entity – such as its establishment to serve a governmental purpose, bond authority, power of eminent domain, or tax status – are not necessarily probative of whether there is a danger that private actors/members will pursue their own economic interests rather than the state’s policies. As Professors Areeda and Hovenkamp note, “[m]uch more important are the body’s structure, membership, decision-making apparatus, and openness to the public. Without reasonable assurance that the body is far more broadly based than the very persons who are to be regulated, outside supervision seems required.”<sup>167</sup>

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<sup>164</sup> *Id.* at 1525.

<sup>165</sup> *Bankers Insurance*, 137 F.3d at 1296-97 (surveying cases in various circuits).

<sup>166</sup> *See, e.g., Earles*, 139 F.3d at 1041 (5th Cir. 1998) (“Despite the fact that the Board is composed entirely of CPAs who compete in the profession they regulate, the public nature of the Board’s actions means that there is little danger of a cozy arrangement to restrict competition.”); *Hass v. Oregon State Bar*, 883 F.2d 1453, 1460 (9th Cir. 1989) (“The records of the Bar, like those of other state agencies and municipalities, are open for public inspection. . . . The Board, like the governing body of other state agencies and municipalities, is required to give public notice of its meetings, and such meetings are open to the public.”).

<sup>167</sup> Areeda & Hovenkamp, *supra* note 11, at 500. Professor Elhauge similarly sates that the state action doctrine should focus on the decisionmaking process of the actors claiming a state action defense. He explains that the antitrust cases that distinguish state from private action fit a model which states that “financially interested actors cannot be trusted to decide which restrictions on competition advance the public interest; disinterested, politically accountable actors can.” Elhauge, *supra* note 25, at 688 (emphasis added). The operative rule, according to Elhauge, is that “an anticompetitive restraint is immune from antitrust liability whenever a financially disinterested and politically accountable actor controls and makes a substantive decision in favor of the terms of the restraint.” *Id.* at 696. Elhauge argues that the legislative



Professors Areeda and Hovenkamp are equally critical of the proposition that an entity's non-profit status indicates lack of a profit motive and, therefore, that supervision is not required. "After all," they note, "many antitrust defendants have been nonprofit corporations that acted anticompetitively in behalf of themselves or their members. Indeed, the typical trade or professional association is *itself* a nonprofit organization dedicated to improving the welfare of its members."<sup>168</sup> "The key," they conclude, "is not the profit or nonprofit status of the organization, but the identity of its decision-making personnel."<sup>169</sup>

Similarly, one may question whether public visibility of the activities of professional entities such as bar organizations or accountancy boards is sufficient protection against self-serving conduct. Experience suggests otherwise.<sup>170</sup>

In any event, courts' efforts to determine who is subject to active supervision are not always ideal. For example, in *Valdosta* the Eleventh Circuit held that a hospital peer review committee did not require active supervision because its members worked within a quasi-governmental entity that itself was deemed not to require active supervision. The court noted that the hospital authority was the repository of ultimate decisionmaking power and exercised plenary review of all credentialing decisions. The hospital authority was governed by a board that was appointed by the county, and exercised its review authority in peer review matters through an executive committee. The court did not discuss the composition of either the board or the executive committee.

*Bankers Insurance* is another problematic opinion in this category. The *Bankers*

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history of the Sherman Act "amply supports the view that antitrust embraces the premise that those with financial interests in restraining competition cannot be trusted to do so without judicial review." *Id.* at 698. See also Kevin J. Arquit, *TICOR and its Implications*, C847 ALI-ABA 429, 451 (Jan. 21, 1993) ("The degree of control exercised by the state – through reviews, public accessibility to decisionmakers and their decisions, the degree of autonomy and authority granted by the state and the body's structure and membership – therefore, all become relevant to the inquiry as to whether the entity is more like the state or like a private actor."). Arquit notes that "[a]fter *Ticor*, with its emphasis on causation and public/private motivation analysis, it may be possible to argue more persuasively that hybrid agencies – where there is an inherent risk of decisionmaking based on private interest – should be subject to both parts of the *Midcal* test." *Id.*

<sup>168</sup> Areeda & Hovenkamp, *supra* note 11, at 500 (emphasis in original).

<sup>169</sup> *Id.*

<sup>170</sup> See, e.g., *Goldfarb v. Virginia State Bar*, 421 U.S. 773 (1975) (state and county bars held to have engaged in price fixing by drafting and enforcing minimum fee schedule for certain legal services).



*Insurance* court held that the active supervision requirement was not applicable to an association of residential property insurers created by Florida law and directed to write policies for citizens unable to obtain property and casualty insurance on the voluntary insurance market. The fact that the association members were competitors was discounted for two reasons. First, they did not compete with the association, because the association was created to serve a market segment previously not served by the insurers. And second, participation in the association was not mandatory. The court failed to distinguish between legislative intent and incentives/opportunity to engage in private anticompetitive conduct.

### C. Interstate Spillovers

The state action doctrine fails to account for the efficiency losses and the breakdowns in the political process posed by interstate spillovers. These spillovers – also referred to as “negative externalities” – are the costs absorbed by the citizens of other states when any one state imposes an anticompetitive regulatory scheme. The fact that they have been largely ignored in the courts’ development of the state action doctrine remains a significant problem.<sup>171</sup>

We need look no further than *Parker* itself for a prime example. *Parker* involved a California agricultural marketing program regulating raisin production. It established mechanisms for prorating raisin production within California so as to limit the quantity offered for sale and thereby raise prices. Although almost all of the raisins consumed in the United States were produced in California, between 90 to 95 percent of the California raisins were shipped out of state.<sup>172</sup> Consequently, the benefits of higher prices were largely concentrated in California, but the cost spilled overwhelmingly into other states.

The conduct of municipal utility providers presented a similar spillover scenario in *City of Lafayette* – though intercity, rather than interstate, in nature. That case involved the use of tie-ins, whereby various municipal utility providers offered gas and water service to customers beyond the city limits, but only on the condition that those customers also purchase electricity from the municipality, rather than from competing private providers. The petitioners argued that, as municipalities, they should be presumed to be acting in the public interest. The Court rejected this argument, however, noting that a government entity, like a private firm, could be expected to act in its parochial interest. One manifestation of this inclination would be a tendency to externalize costs to those customers that lack political representation. In the electric utility context, for example “a municipality conceivably might charge discriminatorily higher rates to

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<sup>171</sup> That failing has drawn recent attention from the organized antitrust bar. See ABA Antitrust Section Report, *supra* note 97, at 42 (arguing that although “one might accept” state measures to restrict competition if their effects fell in-state, existing doctrine shields competitive restraints with substantial interstate spillovers).

<sup>172</sup> *Parker*, 317 U.S. at 345.



such captive customers outside its jurisdiction without a cost-justified basis.”<sup>173</sup> Such a practice, the Court observed, “would provide maximum benefits for its constituents while diserving the interests of the affected customers.”<sup>174</sup>

Interstate spillovers have both economic and political consequences. Economics teaches that where decision makers reap the benefits without bearing the costs of an activity, they have incentives to engage in more of that activity than is socially desirable.<sup>175</sup> For example, California might be expected to support a raisin marketing program that cuts output and raises prices beyond levels that maximize welfare for the nation as a whole. Because the benefits overwhelmingly accrue to California and the costs are overwhelmingly borne by other states, California’s incentives are distorted from the standpoint of national allocative efficiency. More generally, when anticompetitive state regulations tend to produce in-state benefits but out-of-state harms, states have incentives to over-regulate in ways that reduce welfare for the nation as a whole. If such a state regulatory regime is allowed to override a national policy in favor of competition, efficiency goals will be frustrated.<sup>176</sup> Furthermore, the problem is exacerbated by the fact that it is self-perpetuating. Enormous political pressure is likely to build in states that are net sufferers of harm to engage in “self-help” by enacting similarly self-interested legislation, with an equal disregard for spillover effects.

Interstate spillovers also are troubling from a political representation perspective. The state action doctrine arose from concerns over state sovereignty and respect for the values of federalism and embodied a judgment that Congress had not intended to restrain the activities of states.<sup>177</sup> Among the important federalism values that underlie the state action doctrine are concerns for political participation.<sup>178</sup> Yet out-of-state citizens adversely affected by spillovers

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<sup>173</sup> *City of Lafayette*, 435 U.S. at 404.

<sup>174</sup> *Id.*

<sup>175</sup> *See, e.g.*, Edwin Mansfield, MICROECONOMICS, THEORY AND APPLICATIONS 458 (3d ed. 1979).

<sup>176</sup> *See generally* Inman & Rubinfeld, *supra* note 54, 75 TEX. L. REV. at 1238-39.

<sup>177</sup> *See supra* Chapter I.A.

<sup>178</sup> *See* Jorde, *supra* note 19, at 256 (“from the perspective of economic federalism values, spill-over costs are contrary to the values of citizen participation and governmental efficiency”); Inman & Rubinfeld, *supra* note 54, at 1211-17 (linking federalism and considerations of political participation); David McGowan & Mark A. Lemley, *Antitrust Immunity, State Action and Federalism, Petitioning and the First Amendment*, 17 HARV. J. L. & PUB. POL’Y 293, 344-45 (1994) (linking federalism and citizens’ ability to hold those governing accountable).



typically have no participation rights and effectively are disenfranchised on the issue.<sup>179</sup> It is a strange sort of federalism that pays homage to the political role of citizens of states that benefit from a regulation but disregards the concerns of citizens of states that are directly harmed.<sup>180</sup>

The state action doctrine's failure to account for effects of interstate spillovers has been broadly condemned by the commentators:

- Professor Jorde urges: "The state action doctrine . . . might be refined by the courts to make clear that state regulation producing substantial spill-over costs is not exempt from the antitrust laws. Parker's solicitude for the regulatory activities of states need not be read to extend to the extrajurisdictional exportation of substantial costs . . . . State regulations producing [spillover] costs, therefore, do not deserve deference."<sup>181</sup>
- Professors Inman and Rubinfeld warn that the present doctrine offers citizens no

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<sup>179</sup> See Inman & Rubinfeld, *supra* note 54, at 1271 ("Although the state-action doctrine under *Midcal* offers citizens a clear political voice in determining regulatory policies within their state, the present doctrine offers no such protection for regulatory policies decided in neighboring states."); Jorde, *supra* note 19, at 253 ("[S]pill-over costs are of special concern because they are borne by citizens who do not have the opportunity to participate in the decision to supplant competition with regulation.").

<sup>180</sup> One answer might be that this is a problem better addressed by the Constitution's negative Commerce Clause. See Elhauge, *supra* note 25, at 732; John E. Lopatka, *State Action and Municipal Antitrust Immunity: An Economic Approach*, 53 *FORDHAM L. REV.* 23, 70-72 (1984). While it is certainly true that the Commerce Clause provides an additional avenue for challenging regulations that result in significant intrastate spillovers, this avenue provides challenges of its own. See, e.g., Jorde, *supra* note 19, at 254-55 ("that doctrine has proved difficult to apply and also may be considered too weak to eliminate exported costs"); Inman & Rubinfeld, *supra* note 54, at 1273 n.228 (terming the doctrine's balancing test "problematic in practice"); William E. Kovacic, *Lessons of Competition Policy Reform in Transition Economies for U.S. Antitrust Policy*, 74 *ST. JOHN'S L. REV.* 361, 403 (2000) (referring to Supreme Court jurisprudence that "timidly applies the Commerce Clause as a check on rent-seeking by individual states"). See generally Frank H. Easterbrook, 26 *J. L. & ECON.* 23, 46 (1983) (discussing the "uncertainty frequently associated with negative Commerce Clause litigation" and referring to the "frequently" leveled criticism that the clause is "too nebulous to be useful"). The most sensible course would therefore appear to be to approach the problem via both avenues, rather than relying on one to the exclusion of the other.

<sup>181</sup> Jorde, *supra* note 19, at 256.



protection for regulatory policies decided in neighboring states.<sup>182</sup> As a consequence, “the resulting economic inefficiencies go unameliorated,”<sup>183</sup> and “nonresidents . . . remain exposed to any resulting monopoly spillovers.”<sup>184</sup> Inman and Rubinfeld recommend requiring antitrust review of “any state regulation with significant monopoly spillovers where the affected out-of-state consumers did not have a direct say in the approval of the regulation.”<sup>185</sup>

- Professors Hovenkamp and Mackerron maintain that the “appropriate question” for state action analysis is not “whether the state wants to regulate, but whether the state or its governmental subdivision is the best regulator of the market at issue.”<sup>186</sup> A regulator whose jurisdiction is too small to extend over “the entire regulated market and the substantial portion of things affected by its externalities,” they conclude, is not the optimal regulator.<sup>187</sup>
- Judge Easterbrook, who otherwise would give states broad leeway in their regulatory activities, draws a sharp line at interstate spillovers. He would permit states to adopt “any regulations they choose, at any level of government they choose, so long as the residents of the state that adopts the regulation also bear the whole monopoly overcharge.”<sup>188</sup> “Under such an approach,” Judge Easterbrook observes, “states could have any rules they want, so long as he who calls the tune also pays the piper.”<sup>189</sup> However, in *Parker*, where California exported a monopoly overcharge, he would have rejected a state action defense.<sup>190</sup>

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<sup>182</sup> Inman & Rubinfeld, *supra* note 54, at 1271.

<sup>183</sup> *Id.*

<sup>184</sup> *Id.* at 1276.

<sup>185</sup> *Id.*

<sup>186</sup> Herbert Hovenkamp & John A. Mackerron III, *Municipal Regulation and Federal Antitrust Policy*, 32 UCLA L. REV. 719, 767 (1985).

<sup>187</sup> *Id.* at 768-69.

<sup>188</sup> Easterbrook, *supra* note 180, at 45 (emphasis in original).

<sup>189</sup> *Id.*

<sup>190</sup> See also Kovacic, *supra* note 180, at 402-03 (noting current doctrine’s failure to account for adverse interstate spillover effects). But see Elhauge, *supra* note 25, at 730-31 (arguing that shifting decision-making responsibility to larger units increases the cost and introduces its own set of distortions and urging that “we may have to tolerate some major



In sum, an unfortunate gap has emerged between scholarship and case law. Although many of the leading commentators have expressed serious concern regarding problems posed by interstate spillovers, their thinking has yet to take root in the law. Such spillovers undermine both economic efficiency and some of the same political representation values thought to be protected by principles of federalism. The Supreme Court has shown awareness and understanding of some spillover concerns<sup>191</sup> but, as highlighted by *Parker*, has not incorporated interstate spillovers as an element in its analysis.<sup>192</sup> In light of the efficiency and political representation concerns identified above, greater recognition of the nation's competition policies in settings involving significant interstate spillovers could provide substantial benefit.

#### D. Municipalities as Market Participants

One author – Professor Ponsoldt – has observed that, post-*Town of Hallie*, municipalities are increasingly engaged in municipally owned business activities, on a profit-making basis where economically and politically feasible, and commonly are exerting law-making power to exclude competitive challenges.<sup>193</sup> Professor Ponsoldt argues that when municipalities decide to enter and control a marketplace and are not supervised by the state, two general outcomes are likely. First, conflicting local rules and policies interfere with national attempts to produce a

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spillovers if we are to have meaningful local autonomy”).

<sup>191</sup> The Court took direct cognizance of *intrastate* spillovers in *City of Lafayette*, noting that decisions of a municipal electric utility may favor the municipality at the expense of “extraterritorial impact and regional efficiency” and could burden consumers living outside the municipality without providing them “meaningful” political recourse. 435 U.S. at 404, 406.

<sup>192</sup> However, none of the Court's recent cases involved fact-patterns that would have brought interstate spillover concerns to the forefront. *Ticor* involved regulation of fees for title search and examination services, affecting transactions on in-state property. 504 U.S. at 627-28. *Omni* involved zoning within a single city. 499 U.S. at 367-69. *Patrick* involved peer-review proceedings at a single hospital. 486 U.S. at 97-99. *324 Liquor* involved mechanisms for raising *in-state* retail liquor prices. 479 U.S. at 340. *Southern Motor Carriers* involved regulation of intrastate trucking rates. 471 U.S. at 50-53. *Town of Hallie* involved sewage treatment for areas surrounding a single city within a single state. 471 U.S. at 36-37. *Hoover* involved admission to the practice of law in Arizona. 466 U.S. at 560-65. *Boulder* involved cable television regulation governing a single city. 455 U.S. at 45-47. *Midcal* involved mechanisms for raising *in-state* retail wine prices. 445 U.S. at 99-100. The practices considered thus tended to affect only particular cities or to raise prices *within* the state at issue. Few posed potential for interstate spillovers. None involved facts suggesting substantial out-of-state harms.

<sup>193</sup> James F. Ponsoldt, *Balancing Federalism and Free Markets: Toward Renewed Antitrust Policing, Privatization, or a “State Supervision” Screen for Municipal Market Participant Conduct*, 48 SMU L. REV. 1783 (1995).



uniform regulatory system and the result may be an inefficient allocation of supply. Second, related to the lack of uniformity and inefficient allocation, some of these divergent policies may extend beyond the particular product and geographic markets at issue and further undermine the operation of the free market system. These are problems the Court recognized in *City of Lafayette*.

Professor Ponsoldt therefore recommends a "market participant" exception to *Town of Hallie*.<sup>194</sup> Such an exception would make the active supervision prong of *Midcal* applicable to municipalities when they engage in the challenged conduct as a commercial participant in the relevant market. The "possibility" of such an exception was recognized by the Supreme Court in *Omni* and was urged by Chief Justice Burger's concurrence in *City of Lafayette*.

In *Omni*, the majority stated in dictum that the *Parker* doctrine "does not necessarily obtain where the State acts not in a regulatory capacity but as a commercial participant in a given market."<sup>195</sup> This was evident, the Court said, from the *Parker* Court's citation of *Union Pacific R. Co. v. United States*,<sup>196</sup> which held unlawful under the Elkins Act certain rebates and concessions made by Kansas City in its capacity as the owner and operator of a wholesale produce market that was integrated with railroad facilities.<sup>197</sup> In rejecting a conspiracy exception to the *Parker* doctrine, the Court in *Omni* held that "with the possible market participant exception, any action that qualifies as state action is *ipso facto* . . . exempt from the operation of

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<sup>194</sup> The Supreme Court has expressly rejected a market participant exception to Eleventh Amendment state sovereign immunity. *College Savings Bank v. Florida Prepaid Postsecondary Education Expense Board*, 527 U.S. 666 (1999). However, some commentators have argued that the Court's reasoning is not readily transferable to the antitrust context. See, e.g., Robert M. Langer & Peter A. Barile III, *Can the King's Physician (Also) Do Not Wrong?: Health Care Providers and a Market Participant Exception to the State Action Immunity Doctrine*, Matthew Bender's Antitrust Report 26 (1999) ("[A market participant] exception can be found in both the history and rationale of the antitrust laws. Furthermore, as the Eleventh Amendment concerns only private actions against the state itself and has fundamental concerns very different from those of the antitrust laws, such an exception in the antitrust context is not at odds with *College Savings Bank*.")

<sup>195</sup> 499 U.S. at 374-75. The Court's statement was in the context of overruling the Fourth Circuit's holding that certain language in *Parker* relating to agreements and conspiracies supported a conspiracy exception to the *Parker* doctrine. The Court explained that the language from *Parker* suggested only that the state action doctrine might not apply when a state acts in a commercial capacity rather than as a sovereign.

<sup>196</sup> 313 U.S. 450 (1941).

<sup>197</sup> *Omni*, 499 U.S. at 374-75.



the antitrust laws.”<sup>198</sup>

Chief Justice Burger’s concurrence in *City of Lafayette* also suggested a market participant exception. The Chief Justice would have limited the Court’s holding in that case to municipalities acting in a proprietary capacity, and he would have imposed a stricter standard to qualify for the state action defense. The Chief Justice would have applied a two-part test to a local government’s proprietary activities. First, “[t]he *threshold inquiry* in determining if an anticompetitive activity is state action of the type the Sherman Act was not meant to proscribe is whether the *activity* is required by the State acting as sovereign.”<sup>199</sup> Second, the Chief Justice would have directed the district court “to take an additional step beyond merely determining – as the plurality would – that any area of conflict between the State’s regulatory policies and the federal antitrust laws was the result of a ‘state policy to displace competition with regulation or monopoly public service.’” This second step would be to determine whether the implied exemption from federal antitrust law “was necessary in order to make the regulatory Act work, ‘and even then only to the minimum extent necessary.’”<sup>200</sup>

Chief Justice Burger reasoned that the same Congress that “meant to deal comprehensively and effectively with the evils resulting from contracts, combinations and conspiracies in restraint of trade” surely would not have intended to allow local governments to engage in such conduct without being subject to the Sherman Act.<sup>201</sup> He further explained:

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<sup>198</sup> *Id.* at 380 (quoting *Hoover v. Ronwin*, 466 U.S. at 568) (emphasis in original).

<sup>199</sup> *City of Lafayette*, 435 U.S. at 425 (Burger, C.J., concurring) (quoting *Goldfarb*, 421 U.S. at 790 (emphasis added by the Chief Justice)).

<sup>200</sup> *Id.* at 425-26. Interestingly, Chief Justice Burger’s formulation of the state action exemption for municipalities could be read to suggest that non-proprietary activities of local governments should enjoy an absolute defense from the Sherman Act. See *Hybud Equipment Corp. v. City of Akron, Ohio*, 742 F.2d 949, 955 (6th Cir. 1984) (the Chief Justice’s position implies that nonproprietary activities would be shielded from antitrust attack without an inquiry into state policy).

<sup>201</sup> *City of Lafayette*, 435 U.S. at 419. Justice Stewart (joined by Justices White, Blackmun, and Rehnquist), dissenting in *Lafayette*, disagreed with the Chief Justice, stating that the Sherman Act simply was not intended to cover the acts of governmental bodies and that “it is senseless to require a showing of state compulsion when the State itself acts through one of its governmental subdivisions.” *Id.* at 428, 432. Justice Stewart also noted that the distinction between “proprietary” and “governmental” activities has been described as a “quagmire” and that a proprietary activity of government nonetheless is governmental. *Id.* at 433-34. Professors Areeda and Hovenkamp likewise note that Chief Justice Burger’s proposed distinction between proprietary and non-proprietary municipal activities “is widely thought to have proved unworkable in identifying appropriate areas of municipal tort liability.” Areeda & Hovenkamp,



"While I agree with the plurality that a State may cause certain activities to be exempt from the federal antitrust laws by virtue of an articulated policy to displace competition with regulation, I would require a strong showing on the part of the defendant that the State so intended. Thus, I would not be satisfied, as the plurality and Court of Appeals apparently are, that the highest policymaking body in the State of Louisiana merely "contemplated" the activities being undertaken by the cities . . . . I would insist, as the Court did in *Goldfarb v. Virginia State Bar* . . . that the State *compel* the anticompetitive activity. Moreover, I would have the Cities demonstrate that the exemption was not only part of a regulatory scheme to supersede competition, but that it was *essential* to the State's plan."<sup>202</sup>

Professors Areeda and Hovenkamp note that many municipal proprietary activities are presumed to have a public purpose. They state that if there is a market participant exception, it should be limited to horizontal situations where the government competes with private firms in the sale of some product or service.<sup>203</sup>

The Federal Circuit, Third Circuit, and Ninth Circuit have appeared willing to entertain the possibility of a market participant exception. The Eighth Circuit has declined to take the lead in adopting such an exception, and some other circuits have been hostile to the idea.

In *Genentech, Inc. v. Eli Lilly and Co.*, the Federal Circuit stated, in dictum, that "[t]o warrant *Parker* immunity the anticompetitive act must be taken in the state's 'sovereign capacity,' and not as a market participant in competition with commercial enterprise."<sup>204</sup> The court also quoted Justice Rehnquist's dissent in *South-Central Timber Dev., Inc. v. Wunnicke*,<sup>205</sup> a case involving the dormant Commerce Clause, for the proposition that "the antitrust laws apply to a State only when it is acting as a market participant."<sup>206</sup> In *A.D. Bedell Wholesale Co. v.*

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*supra* note 11, at 435.

<sup>202</sup> *City of Lafayette*, 435 U.S. at 426 n.6 (emphasis in original).

<sup>203</sup> Areeda & Hovenkamp, *supra* note 11, at 436. Chief Justice Burger noted in *City of Lafayette* that he used the term proprietary "only to focus attention on the fact that all of the parties are in a competitive relationship such that each should be constrained, when necessary, by the federal antitrust laws." 435 U.S. at 422 n.3.

<sup>204</sup> 98 F.2d 931, 948 (Fed. Cir. 1993) (citing *Boulder and Omni*).

<sup>205</sup> 467 U.S. 82, 102 (1984).

<sup>206</sup> Justice Rehnquist, in turn, cited *Jefferson County Pharmaceutical Assn., Inc. v. Abbott Laboratories*, 460 U.S. 150, 154 (1983), for the proposition that the state action doctrine "does not apply where a State has chosen to compete in the private retail market." The issue presented in *Jefferson County* was whether the sale of pharmaceutical products to state and local



*Philip Morris Inc.*, the Third Circuit noted that “[t]here is also a market participant exception to actions which might otherwise be entitled to *Parker* immunity” but held it inapplicable because “the States did not enter the tobacco market as a buyer or seller, nor did they assume control or ownership of any entity within the market.”<sup>207</sup> In *Hedgecock v. Blackwell Land Co.*, the Ninth Circuit stated that “[w]hile a commercial participant exception to *Parker* might be appropriate in circumstances where an arm of the state enters a market in competition with private actors . . . such is not the case here.”<sup>208</sup>

The Eighth Circuit has noted the possibility of a market participant exception but declined to take the lead, noting that “the market participant exception is merely a suggestion [in *Omni*] and is not a rule of law.”<sup>209</sup> “Until such a transformation occurs,” it would continue to apply the *City of Lafayette* standard for determining whether a municipal market participant was exempt from the Sherman Act.<sup>210</sup>

Some of the other circuits have been less open to a market participant exception. A proprietary activity exception was rejected by the Eleventh Circuit in *McCallum v. City of Athens*,<sup>211</sup> which cited *Garcia v. San Antonio Metropolitan Transit Authority*,<sup>212</sup> for the proposition that there is no meaningful distinction, for purposes of a state action defense, between “governmental” and “proprietary” activities.<sup>213</sup> In *Valdosta*, the Eleventh Circuit again

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government hospitals for resale in competition with private retail pharmacies is exempt from the proscriptions of the Robinson-Patman Act. The Court held that Congress did not so intend, based on the plain language of the Act and its legislative history.

<sup>207</sup> 263 F.3d 239, 265 n.55 (3d Cir. 2001).

<sup>208</sup> No. 93-16604, 1995 WL 161649, at \*2 (9th Cir. Apr. 7, 1995) (unpublished opinion). However, the Ninth Circuit has also stated that the distinction between “integral” and “proprietary” government functions is “unworkable” and was “repudiated” by the Supreme Court. See *Lancaster Community Hospital v. Antelope Valley Hospital District*, 940 F.2d 397, 402 n.9 (9th Cir. 1991). See also *Kern-Tulare Water District v. City of Bakersfield*, 828 F.2d 514 (9th Cir. 1987) (stating, without discussion, that the governmental/proprietary distinction is inapplicable); *Areeda & Hovenkamp*, *supra* note 11, at 435.

<sup>209</sup> *Paragould Cablevision v. City of Paragould*, 930 F.2d 1310, 1313 (8th Cir. 1991).

<sup>210</sup> *Id.* at 1313.

<sup>211</sup> 976 F.2d 649 (11th Cir. 1992).

<sup>212</sup> 469 U.S. 528 (1985).

<sup>213</sup> Note, however, that the Supreme Court’s statement in *Omni* regarding the possibility of a market participant exception came well after *Garcia* was decided.



“decline[d] to address the Supreme Court’s invitation to employ a ‘market participant’ exception,” and stated that to “withhold immunity in those cases where the state chooses ‘to enter an area of business ordinarily carried on by private enterprise,’ would be to virtually eliminate state action immunity altogether.”<sup>214</sup> The Tenth Circuit rejected a market participant exception in *Allright Colorado, Inc. v. City and County of Denver*,<sup>215</sup> and the Sixth Circuit likewise rejected such an exception in *Hybud Equipment Corp. v. City of Akron, Ohio*.<sup>216</sup>

While these cases identify a legitimate hurdle to broader acceptance of a market participant exception – the fact that there is not always a clear distinction between a municipality’s activities as a regulator and a market participant – this hurdle is not necessarily insurmountable. Professors Areeda and Hovenkamp, for example, provide a likely starting point with their observation that horizontal situations, in which the government competes with private firms in the sale of some product or service, present a relatively bright line. Clearer guidance regarding closer cases could then be provided through case-by-case adjudication. This type of incremental line drawing is a task to which the federal common law system is both well accustomed and well suited.

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<sup>214</sup> 93 F.3d at 1525-26 & n.14 (citing and rejecting a state court case stating that sovereign immunity under Georgia state law is intended to protect the government as it goes about the business of governing). *See also Lee County*, 38 F.3d at 1191 n.5 (citing *McCallum*, the Eleventh Circuit rejected the FTC’s contention that the anticompetitive behavior of a political subdivision acting in a private capacity is not a foreseeable effect of legislation which grants authority to that political subdivision).

<sup>215</sup> 937 F.2d 1502, 1510 & n.11 (10th Cir. 1991) (“The fact that the City is also in some sense a competitor of plaintiffs does not alter the basic test for state action immunity . . . . The City’s additional status as a possible competitor, or its possible engagement in a ‘proprietary’ activity, is not determinative.”). *See also Pueblo Aircraft Service, Inc. v. City of Pueblo, Colorado*, 679 F.2d 805 (10th Cir. 1982).

<sup>216</sup> 742 F.2d 949, 956 (6th Cir. 1984).



## CHAPTER III

### POSSIBLE APPROACHES

Some commentators have argued that *Parker v. Brown* is fundamentally flawed and should be overturned, whether through legislation or by successfully advocating such a position before the Supreme Court. For example, Professors Lopatka and Page believe that government regulation is, arguably, the most durable source of monopoly power, and that limiting the ability of state governments to erect anticompetitive barriers would doubtless enhance consumer welfare in many respects.<sup>217</sup> Professors Lopatka and Page further observe that, though support for such an approach is not widespread, it is far from non-existent. In his concurrence in *Ticor*, for example, Justice Scalia stated that “I am skeptical about the *Parker v. Brown* . . . exemption for state-programmed private collusion in the first place.”<sup>218</sup>

The Task Force has not considered the wisdom or practicality of any such fundamental challenge to state action doctrine. Instead, the Task Force has considered other, more narrowly focused recommendations, which are discussed under the headings that follow.

#### **Recommendation 1:**

##### **Re-affirm a clear articulation standard tailored to its original purposes and goals.**

As explained in Chapter I, the clear articulation standard was developed as a mechanism to harmonize state and national policies affecting competition. The national policy favoring competition remains, except when supplanted by a “deliberate and intended state policy.”<sup>219</sup> The standard is intended to help in identifying situations where such state policies are actually intended to supplant the antitrust laws, and it must be applied in a manner befitting that goal.

Chapter II.A. highlights two common pitfalls in the case law. A number of courts of appeals have conflated a general authorization of conduct with a specific intention to displace competition. Both are necessary elements of a clearly articulated policy to displace competition, and each should be separately addressed. In other cases the courts have been too quick to jump from finding a general regulatory scheme in an industry to concluding that such a scheme shelters all forms of anticompetitive conduct under it. These courts stop their analysis without ever inquiring whether the state intended to displace competition in the manner at issue. In both settings, some courts have recognized a state action defense without asking if, in fairness, the state could be deemed to have intended that result.

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<sup>217</sup> Lopatka & Page, *supra* note 4, at 65.

<sup>218</sup> 504 U.S. at 641 (Scalia, J., concurring).

<sup>219</sup> *Id.* at 636.



To a large extent, the problem derives from an undue reliance on “foreseeability” analysis. Some lower courts have taken foreseeability – rather than a policy to displace competition – as the ultimate standard. Some have reasoned that because given conduct is broadly authorized, it must be foreseeable. Others have assumed that the creation of a broad regulatory regime makes all anticompetitive regulation foreseeable. In each instance, these courts conclude that there has been clear articulation upon finding foreseeability. As discussed above, however, that was never the Supreme Court’s intention. Where the Court has spoken in terms of foreseeability, it has used the concept as a tool for probing the state’s intentions and policies, not as an end in itself.

An appropriate clear articulation standard, therefore, would ask both: (i) whether the conduct at issue has been authorized by the state, and (ii) whether the state has deliberately adopted a policy to displace competition in the manner at issue.<sup>220</sup> The separation into two elements drives home that mere authorization is not enough. The insistence on authorization<sup>221</sup> would preserve competition in cases like *Cost Management* and *Columbia Steel Casting*,<sup>222</sup> where the state had never authorized the anticompetitive conduct at issue. The insistence on a policy to displace competition<sup>223</sup> would also preserve competition in cases where courts have

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<sup>220</sup> As the Court has made clear, the state would not need to articulate an express policy displacing competition in the precise manner at issue. Rather, the policy to displace competition could be drawn from the words of the statute, any clear legislative history, and the nature of the authorized conduct (*e.g.*, the extent and overall nature of the relevant regulatory regime).

<sup>221</sup> Professors Lopatka and Page also advocate an authorization requirement, although they describe the requirement in terms of the specificity of the state policy. *See Lopatka & Page, supra* note 4, at 46. They also recommend principles for implementing such a requirement. Specifically, Professors Lopatka and Page adopt as their model the administrative law principle of a “clear statement.” *Id.* at 48. Applying this principle to the state action context would require a state legislature to clearly express its intent to compromise the national policy in favor of competition in order to support a state action defense. Reviewing courts would consequently be required to construe statutes narrowly, with the presumption that the legislature intended to abridge as little competition as possible. *Id.* at 49.

<sup>222</sup> *See supra* p. 36.

<sup>223</sup> Once again, Professors Lopatka and Page advocate a similar requirement, although they describe it in somewhat different terms. Prior to recognizing a state action defense, Professors Lopatka and Page urge that a court be required to identify a positive state policy. *See Lopatka & Page, supra* note 4, at 55. Although the Supreme Court has suggested that a state action defense does not depend on the content of a state policy, Professors Lopatka and Page point out that the Court has also stated that the state action doctrine does not authorize “naked” repeals of federal antitrust law. Thus, a court is permitted to examine the content of the



jumped from mere authority to contract, to make purchases, or to otherwise engage in general business activities all the way to findings of clear articulation.<sup>224</sup> The requirement that there be a policy to displace competition *in the manner at issue* would address situations where courts have stopped their analysis prematurely on finding a broad regulatory scheme.<sup>225</sup> Together, these requirements would re-focus the inquiry on the relevant question of whether in a given case there actually are deliberate and intended state policies that would justify setting aside national antitrust goals.<sup>226</sup>

### **Recommendation 2:**

#### **Clarify and strengthen the standards for active supervision.**

As discussed in Chapter II.B., the Supreme Court has not provided much specific guidance on the kind of state review of private actions that would constitute “active” supervision,

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state policy underlying a particular restraint, though only enough to determine that it is, in fact, a positive policy, capable of judicial interpretation, rather than a mere nullification of the antitrust laws. *Id.* at 54-55.

<sup>224</sup> See *supra* Chapter II.A.1. Under the recommended standard, for example, the court in *Bankers Insurance* would have been prevented from merely noting that the insurers’ association was authorized to enter service contracts if it wished, and instead would have been required to ask whether there was any indication of a state policy to displace competition in awarding service contracts. Similarly, in *Sterling Beef* the court would have been prevented from merely finding that the municipality was permitted to acquire gas works, and instead would have been required to find that there was a policy to shut out competitors. In *Lee County* the court would have been required to determine, first and foremost, whether the legislature had adopted a policy to displace competition.

<sup>225</sup> For example, the court in *Sandy River Nursing Care* would have been prevented from relying on the general, regulatory approach to ratemaking, when the statute stipulated that approved rates were upper limits, but the harm alleged was an agreement not to charge less than the maximum. Likewise, the court in *Earles* would have required more than a general assignment of authority to regulate public accounting before concluding that a board of CPAs was permitted to block competition from securities brokers.

<sup>226</sup> Foreseeability would remain part of the inquiry, as a tool for ascertaining state policy, rather than as an end in itself. In those cases in which anticompetitive effects “logically would result” from the statutory authority, such as *Town of Hallie*, or in which the authorized zoning “necessarily” tends to exclude entrants, such as *Omni*, finding “foreseeability” is merely another means of expressing the conclusion that a particular displacement of competition reflects a deliberate and intentional state policy. As long as the ultimate focus is directed toward ascertaining state policy, foreseeability considerations can continue to assist the inquiry.



in terms of either the kind of scrutiny required by the state official or procedural requirements.<sup>227</sup> Nor do the cases provide specific guidance on the kind of scrutiny appropriate to Commission or federal court review of state action.

The Supreme Court's main opinion in this area, *Ticor*, addresses the extreme situations but not the more common middle range. In that case, the Court held that it was not sufficient for the states to have a review mechanism formally in place. The state review also had to be effectively carried out in practice. While helpful in principle, the decision is of only limited practical benefit on this point, as a result of the stark factual situations involved in the case. The *Ticor* Court assumed that the state supervision at issue was virtually non-existent. It referred, for example, to "the clear absence of state supervision."<sup>228</sup> The case therefore did not clarify the standards that would apply to the more ordinary situation in which states have provided some substantive review, but where shortcomings of that review are nevertheless apparent. A possible "*Ticor II*" case could establish standards for these more common, real world situations.

This clearer, more easily administrable standard for active supervision would need to be well grounded in existing Supreme Court precedent. The Supreme Court has made clear that the active supervision requirement is a rigorous one. It is not enough that the state grants general authority for certain business conduct or that it approves private agreements with little review. As the Court held in *Midcal*, "[t]he national policy in favor of competition cannot be thwarted by casting such a gauzy cloak of state involvement over what is essentially a private price-fixing arrangement."<sup>229</sup> Rather, active supervision is designed to ensure that a private party's anticompetitive action is shielded from antitrust liability only when "the State has effectively made [the challenged] conduct its own."<sup>230</sup>

In order for state supervision to be adequate for state action purposes, state officials must engage in a "pointed re-examination" of the private conduct.<sup>231</sup> In this regard, the state must "have and exercise ultimate authority" over the challenged anticompetitive conduct.<sup>232</sup> To do so, state officials must exercise "sufficient independent judgment and control so that the details of the rates or prices have been established as a product of deliberate state intervention, not simply

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<sup>227</sup> As earlier noted, the *Ticor* Court declined to impose specific procedural requirements for a state supervision.

<sup>228</sup> 504 U.S. at 639.

<sup>229</sup> 445 U.S. at 105-06.

<sup>230</sup> *Patrick*, 486 U.S. at 106.

<sup>231</sup> *Midcal*, 445 U.S. at 106. See also *Ticor*, 504 U.S. at 634-35; *Patrick*, 486 U.S. at 100-01.

<sup>232</sup> *Patrick*, 486 U.S. at 101 (emphasis added).



by agreement among private parties.”<sup>233</sup> One asserting the state action defense must demonstrate that the state agency has ascertained the relevant facts, examined the substantive merits of the private action, assessed whether the private action comports with the underlying statutory criteria established by the state legislature, and squarely ruled on the merits of the private action in a way sufficient to establish the challenged conduct as a product of deliberate state intervention rather than private choice.

At its core, the active supervision requirement serves to identify those responsible for public policy decisions. The clear articulation requirement ensures that, if a state is to displace national competition norms, it must replace them with specific state regulatory standards. A state may not simply authorize private parties to disregard federal laws,<sup>234</sup> but must genuinely substitute an alternative state policy. The active supervision requirement, in turn, ensures that responsibility for the ultimate conduct can properly be laid on the state itself, and not merely on the private actors. As the Court explained in *Ticor*:

“States must accept political responsibility for actions they intend to undertake . . . . Federalism serves to assign political responsibility, not to obscure it . . . . For states which do choose to displace the free market with regulation, our insistence on real compliance with both parts of the *Midcal* test will serve to make clear that the state is responsible for the price fixing it has sanctioned and undertaken to control.”<sup>235</sup>

Through the active supervision requirement, the Court is furthering the fundamental principle of “accountability” that underlies federalism, by ensuring that, if allowing anticompetitive conduct proves to be unpopular with a state’s citizens, the state’s legislators will not be “insulated from the electoral ramifications of their decisions.”<sup>236</sup>

In short, clear articulation requires that a state enunciate an affirmative intent to displace competition and to replace it with a stated criterion. Active supervision requires the state to examine individual private conduct, pursuant to that regulatory regime, to ensure that it comports with that stated criterion. Only then can the underlying conduct accurately be deemed that of the state itself, and political responsibility for the conduct fairly be placed with the state.

There is, as yet, no single procedural or substantive standard that the Supreme Court has held a state must adopt in order to meet the active supervision standard. Therefore, satisfying the Supreme Court’s general standard for active supervision, described above, is and will remain the

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<sup>233</sup> *Ticor*, 504 U.S. at 634-35.

<sup>234</sup> *Parker*, 317 U.S. at 351.

<sup>235</sup> 504 U.S. at 636.

<sup>236</sup> *New York v. United States*, 505 U.S. 144, 168-69 (1992).



ultimate test for that element of the state action defense. Nevertheless, in light of the foregoing principles, the Commission could identify the specific elements of an active supervision regime that it would consider in determining whether the active supervision prong of state action is met in future cases. These elements would likely include the following, all of which further the central purpose of the active supervision prong by ensuring that responsibility for the private conduct is fairly attributed to the state:

- the development of an adequate factual record, including notice and an opportunity to be heard;
- a written decision on the merits; and
- a specific assessment – both qualitative and quantitative – of how private action comports with the substantive standards established by the state legislature.<sup>237</sup>

**Recommendation 3:**

**Clarify and rationalize the criteria for identifying the quasi-governmental entities that should be subject to active supervision.**

As discussed in Chapter II.B., circuit courts look to a laundry list of factors to determine whether a hybrid, quasi-governmental entity should be subject to the active supervision requirement. A number of these factors, which reflect the governmental attributes of the entity, are not necessarily probative of whether there is a danger that private actors/members will pursue their own economic interests rather than the state's policies. The laundry list includes factors such as the establishment of the entity to serve a governmental purpose, tax exemption, bond authority, power of eminent domain, nonprofit status, and public visibility.

There are two similar approaches the Commission could take to address this problem. First, the Commission could assert that the active supervision prong of *Midcal* should apply to any entity consisting in whole or in part of market participants. Support for this approach is found in Areeda and Hovenkamp, who “would presumptively classify as ‘private’ any organization in which a decisive coalition (usually a majority) is made up of participants in the regulated market.”<sup>238</sup> To protect against “capture” or conspiratorial involvement of governmental

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<sup>237</sup> The Commission recently adopted this three element active supervision standard in the *Indiana Movers* case. See *Indiana Household Movers and Warehousemen, Inc.*, Docket No. C-4077, at 5 (Apr. 25, 2003) (Analysis to Aid Public Comment) (“*Indiana Movers Analysis*”) available at <<http://www.ftc.gov/os/2003/03/indianahouseholdmoversanalysis.pdf>>.

<sup>238</sup> Areeda & Hovenkamp, *supra* note 11, at 501. Professors Areeda and Hovenkamp would vary the strength of the presumption with the strength of the competitive relationship between the decision-maker and the plaintiff. “[T]he presumption should become virtually



representatives within the entity, a further requirement should be that the active supervision be performed by a governmental official/entity outside the entity in question.

A second approach would entail a more rigorous, case-by-case analysis of whether there is an appreciable risk that the challenged conduct is the result of private actors pursuing their private interests rather than state policy. This approach would look to such factors as the entity's structure, membership, decision-making apparatus, and openness to the public.<sup>239</sup> It could also incorporate the suggestion of Professors Areeda and Hovenkamp that "the strongest criterion for identifying the relevant actor" should be the degree of discretion private actors had to make the challenged decision.<sup>240</sup>

#### **Recommendation 4:**

**Encourage judicial recognition of the problems associated with overwhelming interstate spillovers, and consider such spillovers as a factor in case and *amicus*/advocacy selection.**

As discussed in Chapter II.C., the state action doctrine has been criticized by leading commentators for its failure to take interstate spillovers into account. When one state regulates activities in a manner that overwhelmingly imposes the cost of regulation on citizens of other states, both economic efficiency and the political participation goals of federalism are impaired. The gap between the commentators and the case law, however, is significant. Not only does the case law fail to account for the concerns raised by the analysts, but *Parker* itself shielded conduct that resulted in very substantial interstate spillovers.

The Commission could help to introduce sensitivity to such spillovers into the case law, either through its adjudicatory/litigation positions or through selective *amicus* filings.<sup>241</sup>

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conclusive where the organization's members making the challenged decision are in direct competition with the plaintiff and stand to gain from the plaintiff's discipline or exclusion." *Id.*

<sup>239</sup> Professors Lopatka and Page place particular emphasis on this factor, which they define more precisely as "political legitimacy." In their view, "Congress is willing to defer to states that adopt policies inconsistent with the national policy embodied in the antitrust laws, but only when the conflicting policies are the direct product of the political process that defines the state as a sovereign entity." Lopatka & Page, *supra* note 4, at 33. Stated more plainly, placing the conduct of a state actor under the auspices of the state action doctrine is appropriate only when balanced by the fact that "the actor is directly accountable to the state's electorate." *Id.*

<sup>240</sup> Areeda & Hovenkamp, *supra* note 11, at 501.

<sup>241</sup> This accords with the ABA Antitrust Section's recent call for "[g]reater attention to the hazards of that form of state intervention that generates substantial adverse spillovers."



Consideration of the spillover problem might begin to grow even from mere kernels of recognition, such as judicial dicta recognizing that applying a state action defense would be particularly harmful in a given case in light of the overwhelming interstate spillover costs. Settings involving overwhelming interstate spillovers may be particularly appropriate vehicles for the Commission's advocacy, *amicus*, and enforcement efforts.<sup>242</sup>

Moreover, under a tiered approach to the state action doctrine – like that discussed in Chapter I.C.2. – the presence of overwhelming interstate spillovers could be urged as a factor compelling more rigorous application of the clear articulation and active supervision requirements.

**Recommendation 5:**

**Clarify and strengthen the market participant exception to *Town of Hallie*.**

As discussed in Chapter II.D., a municipality's participation in a market as a competitor is likely to have market distorting effects if the municipality is not subject to the same rules of competition as private competitors. While a state may elect to allow market participation by municipalities, the assumption in *Town of Hallie* that a municipality's motives and incentives are consonant with the public interest, and are not like those of a private actor, does not necessarily hold true when the municipality enters a market in a proprietary capacity as a competitor. An active supervision requirement would ensure that the municipality's behavior is consistent with state policy.

**Recommendation 6:**

**Undertake a comprehensive effort to address emerging state action issues through the filing of *amicus* briefs in appellate litigation.**

As the discussion in Chapters I and II makes clear, Supreme Court case law has left open many important questions regarding the scope of the state action doctrine. When required to fill the gaps, the courts of appeals have shown varying degrees of sensitivity to competition policy values. The Commission can play an important role in explaining those values to the federal

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ABA Antitrust Section Report, *supra* note 97, at 42.

<sup>242</sup> When the decree of spillover is more marginal, and difficult to measure, prudence and a desire for legal rules with *ex ante* predictability counsel against giving significant weight to interstate spillovers. But where the benefits of a given anticompetitive restriction accrue overwhelmingly to residents of the state implementing the restriction, and the harms fall overwhelmingly on residents of other states, then the considerations behind both the Interstate Commerce Clause and the federal antitrust laws are at their height, and the case for judicial recognition of those spillovers is at its strongest.



courts in a manner that best ensures that antitrust concerns receive appropriate weight. Substantial benefits could flow from an active *amicus* program directed toward: (i) identifying, in a timely fashion, significant appellate litigation in which presentation of the Commission's views might make a significant contribution; and (ii) preparing and filing *amicus* briefs setting forth the agency's views.

Indeed, in recent years both the Commission and the Antitrust Division have successfully employed *amicus* filings to help shape the state action doctrine at the court of appeals level. In 1998 the agencies filed a joint brief in the Fifth Circuit's *Hammond* litigation, first urging rehearing *en banc* and then convincing the *en banc* panel to reverse a three-judge decision that had treated a hospital's authority to enter contracts as clear articulation sufficient to shield the anticompetitive exclusion of a competitor. The briefs provided support for the court's ultimate determination to re-focus clear-articulation analysis on ascertaining whether the state had actually adopted a policy to displace competition.<sup>243</sup> Similarly, an Antitrust Division *amicus* filing helped to convince the Ninth Circuit in 1996 to withdraw an opinion and change the outcome of the *Columbia Steel Casting* litigation. The court expressly relied on the Division's *amicus* brief in concluding that it initially had erred in applying a foreseeability test with reference to conduct that was not even authorized by the governing statute.<sup>244</sup>

*Amicus* activity of this nature can be an effective means of raising judicial awareness of competition values and channeling development of the law. Staff recommends that it be actively pursued, with resources sufficient for timely identification of *amicus* opportunities and development of thoughtful *amicus* filings.

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<sup>243</sup> *Hammond*, 171 F.3d at 233-36. The agencies also filed a joint *amicus* brief in support of an appeal from a district court opinion in *Willis-Knighton Medical Center v. City of Bossier*, 2 F. Supp. 842 (W.D. La. 1997), which raised issues similar to those in *Hammond*. The Fifth Circuit reversed the trial court ruling without a published opinion. *Willis-Knighton v. Bossier City*, 178 F.3d 1290 (5th Cir. 1999).

<sup>244</sup> See *Columbia Steel Casting*, 111 F.3d at 1443-44.



## CHAPTER IV

### PRIOR COMMISSION LITIGATION INVOLVING STATE ACTION

Over the years, the Commission has addressed the potential competitive impact of state regulation on numerous occasions, through law enforcement actions, *amicus* briefs, and competition advocacy. Some of the principal matters from the agency's recent history are reviewed in this chapter. This discussion is intended to identify some relevant items from the historical record, and also to see what lessons those experiences can teach about the particular contexts in which different approaches to state-action problems are more or less effective.

#### A. The Taxicab Litigation

The Commission conducted a ten year staff study of municipal regulation of taxicabs, beginning in the 1970s. From among the cities studied, the Commission selected two for litigation. This resulted in the issuance of complaints in 1984 against New Orleans<sup>245</sup> and Minneapolis.<sup>246</sup> In each instance it appeared that the city was regulating taxi fares and entry into the taxi market, without having been sufficiently authorized by its state legislature to do so. In antitrust terms, the complaint in each matter alleged that the municipality had conspired with and facilitated a conspiracy among taxicab owners, resulting in an illegal agreement on terms of trade, including fares and entry.

Both complaints were dismissed before trial, however, as a result of further state action. In the case of New Orleans, the state legislature passed an aggressive supplemental statute. The statute explicitly declared a policy that municipalities should regulate taxicabs and should be exempt from federal antitrust liability while doing so.<sup>247</sup> In the case of Minneapolis, by contrast, the city government took a more conciliatory approach. It amended its code to increase the number of taxi licenses available, with an initial increase from 248 to 323 licenses and additional increases of as many as 25 licenses per year thereafter.<sup>248</sup> In light of these events, the Commission terminated both litigations.

Each of these cases can be thought of as having achieved a somewhat desirable outcome.

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<sup>245</sup> *City of New Orleans*, 105 F.T.C. 1 (1985).

<sup>246</sup> *City of Minneapolis*, 105 F.T.C. 304 (1985).

<sup>247</sup> In relevant part this statute recites that "the policy of this state is to require that municipalities . . . regulate [taxicabs] and not to subject municipalities or municipal officers to liability under federal antitrust laws." 105 F.T.C. at 5.

<sup>248</sup> See 105 F.T.C. at 309.



They either loosened the competitive restrictions, or, at a minimum, forced the state to be explicit about its anticompetitive policy choices. On the other hand, the two cases also remind us that litigation in this area can be affected by legislation that can alter the relevant facts at any time, thus creating an extra layer of complexity and uncertainty.

In addition to litigation involving municipal regulation of taxicabs, the Commission has engaged in numerous advocacy efforts in this area. For example, in 1986, then Chairman Daniel Oliver sent a letter to New York City Mayor Ed Koch warning that restrictions on taxi medallions lead to higher fares and reduced availability of taxis and urging deregulation. While the city did not deregulate the industry, it did introduce a bill to increase the number of medallions available. In 1987, the Commission staff urged the city of Cambridge, Massachusetts, to deregulate its taxicab system. In the same year, staff also recommended that the Seattle City Council reject the parts of a proposed taxi ordinance that set fares and restricted the number of taxis, and thus retain its deregulated system. In 1990, the Massachusetts Department of Public Utilities quoted a 1989 FTC staff comment in its decision to increase the number of Boston taxicab medallions by 33 percent.

#### **B. The State Regulatory Board Litigation**

During this same period the Commission also conducted a series of litigations involving state regulatory boards and industry groups that appeared before them. Because the law of state action was evolving during this time, some of these cases were more successful than others. In some actions, the agency was able to establish important principles of liability. In *Massachusetts Board of Registration in Optometry*,<sup>249</sup> for example, the Commission found that the respondent's conduct contradicted the state command not to restrict truthful advertising. In other words, the state had not articulated any policy "to displace competition with regulation." In some other matters, however, the Commission encountered difficulties, albeit not necessarily of its own making. For example, one FTC matter was remanded after the case law evolved to hold that the state action defense would be available even when the state policy merely permitted, rather than required, the anticompetitive conduct at issue.<sup>250</sup>

#### **C. The "Eyeglasses II" Rulemaking**

Another project attempted to find a path around the normal restraints of the state action defense through a creative use of the Commission's rulemaking powers. This was the "Eyes II"

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<sup>249</sup> 110 F.T.C. 549 (1988).

<sup>250</sup> *Massachusetts Furniture & Piano Movers Ass'n v. Federal Trade Commission*, 773 F.2d 391 (1st Cir. 1985).



rulemaking.<sup>251</sup> It was intended to preempt anticompetitive state restrictions on the commercial practice of optometry. The Commission adopted a rule declaring that it was “an unfair act or practice” for “any state or local governmental entity” to prevent optometrists from following any of several enumerated practices, such as operating under trade names, locating in shopping centers, or operating multiple offices. The rule provided that it could be cited as a defense to any state proceeding brought against an optometrist for violation of one of the disallowed state rules. The Commission reasoned that: (i) this was an exercise of its statutory rulemaking power, (ii) that rulemaking was a delegated legislative power, and (iii) this power was intended to be broader and more flexible than the FTC’s powers in litigation. Based on this reasoning, the Commission concluded that the state action doctrine would not limit this exercise of its rulemaking power in the same way that it would limit the Commission’s power to enforce the antitrust laws.

Upon judicial review, however, the D.C. Circuit disagreed.<sup>252</sup> The court observed that the “Eyes II” rule would apply even when the state was acting in its sovereign capacity. Based on this observation, the court held that the presumptions about legislative intent prohibited a federal agency from preempting state legislation in this way. The policy considerations were the same in the litigation and the rulemaking contexts, the court held, and it would not assume, from a silent legislative history, that Congress intended to make a change in that policy.

#### **D. The Superior Court Trial Lawyers Litigation**

Another matter during this period resulted in litigation that eventually reached the Supreme Court: *Federal Trade Commission v. Superior Court Trial Lawyers’ Association*.<sup>253</sup>

This case involved a boycott organized by an association of criminal defense lawyers in the District of Columbia, who pledged not to accept additional cases until their rate of reimbursement was increased. In some respects this case was a straightforward application of horizontal restraint principles. There was an agreement on prices, a boycott, a capitulation by the customer, and an actual price increase. The case also raised state action issues, however, because the respondents claimed, and the administrative law judge (“ALJ”) initially found, that the D.C. government’s supportive posture toward the boycott meant that there were “no adverse

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<sup>251</sup> Ophthalmic Practice Rules, 54 Fed. Reg. 10285 (March 13, 1989). Chairman Oliver voted against adoption of the rule.

<sup>252</sup> *California State Board of Optometry v. Federal Trade Commission*, 910 F.2d 976 (D.C. Cir. 1990).

<sup>253</sup> *Federal Trade Commission v. Superior Court Trial Lawyers’ Ass’n*, 493 U.S. 411 (1990).



effects.”<sup>254</sup>

The ALJ initially dismissed the complaint on the basis of “evidence indicating that city officials (and practically everyone else concerned with the criminal justice system) were convinced [that] the optimal economic price was inadequate [and the defense] lawyers were unlikely to achieve higher fees if they continued to rely on communicative political petitioning alone.”<sup>255</sup>

Both the full Commission and the Supreme Court eventually rejected this reasoning, however. The Commission found that the city had certainly suffered economic loss, to the extent of spending an additional \$4 million to \$5 million a year on legal services for the indigent.<sup>256</sup> Moreover, it concluded that the record did not support a conclusion that the D.C. government had, in fact, supported the boycott. Most fundamentally, for purposes of the state action issue, the Commission concluded that informal, *post hoc* approval by the city did *not* constitute the kind of state action that would shield the conduct. The Commission drew on the Supreme Court’s decision in *United States v. Socony-Vacuum Oil Co.*,<sup>257</sup> reasoning that if a “knowing wink” defense to the antitrust laws were permitted, national competition policy would be determined “not by Congress nor by those to whom Congress has delegated authority but by virtual volunteers.”<sup>258</sup>

#### E. The *Ticor* Title Litigation

Another matter that reached the Supreme Court was *Federal Trade Commission v. Ticor Title Insurance Co.*<sup>259</sup> *Ticor* involved a challenge to title insurance companies’ practice of agreeing among themselves on the fees they would charge for background title searches.<sup>260</sup> Such agreements were authorized by the law of many states. In some of these states, however, the Commission found that the agreements were not actively supervised, and therefore would not be covered by the state action doctrine.

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<sup>254</sup> 107 F.T.C. 510, 560 (1984).

<sup>255</sup> *Id.* at 560.

<sup>256</sup> *Id.* at 577.

<sup>257</sup> 310 U.S. 150, 226 (1940).

<sup>258</sup> 107 F.T.C. at 578 (quoting *Socony-Vacuum Oil*).

<sup>259</sup> 504 U.S. 621 (1992).

<sup>260</sup> By challenging only agreements on the fee for the underlying title examination, the Commission avoided other aspects of title insurance work that might constitute the “business of insurance.”



The litigation in *Ticor* involved states with relatively lax supervision. The Commission had focused its efforts on the small number of states that failed to satisfy their obligation to supervise actively. By the time the matter reached the Supreme Court there were four states under review. The Court found either that those states had failed to supervise actively, or that the matter should at least be considered on remand, so that the focused, limited case was, in fact, successful.

The Court's decision involved a fairly narrow range of fact patterns. The Court found that all four states used some form of "negative option" review. Furthermore, two of the four did not follow the required regulatory procedures, and a third failed to follow similar procedures that were available to it.<sup>261</sup> On these facts, the Court's decision did not fully clarify the general standards for active supervision that would apply to other situations.

The outcome of this case demonstrates the difficulties associated with the "walking a fine line approach" that the Commission must frequently take. FTC litigation in the state action area has been most effective when it focuses on a narrowly defined, and carefully selected, set of targets. Nevertheless, this approach may also encourage reviewing courts to decide such cases on similarly limited grounds, thereby leaving the broader issues of state action policy unresolved.

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<sup>261</sup> *Id.* at 629-30.



## CHAPTER V

### RECENT COMMISSION ACTIVITIES INVOLVING STATE ACTION

In the nearly two years since its formation, the Task Force has endeavored to address important state action issues whenever they arise. The Task Force's efforts, which include a number of open matters and ongoing investigations, have included law enforcement actions, *amicus* briefs, and competition advocacy. This chapter provides a brief description of the subset of those matters that have already been litigated to completion or resulted in public statements by the FTC or its staff.

#### A. Litigation

##### 1. *Indiana Movers*

The *Indiana Movers* case provided the Commission with an opportunity to offer both state regulators and the antitrust bar clear and authoritative guidance regarding the "active supervision" requirement. The case involved allegations of anticompetitive conduct by Indiana Household Movers and Warehousemen, Inc. – an association representing approximately 70 household goods movers. One of the association's primary functions is to prepare and file tariffs, and tariff supplements, on behalf of its members with the Indiana Department of Revenue. According to the Commission's complaint, however, the association actively engaged in the establishment of collective rates to be charged by competing movers.<sup>262</sup> In order to resolve this allegation, the Commission and the association entered into a consent order. The order prohibits the association from knowingly preparing or filing tariffs containing collective rates, facilitating communications between member carriers concerning rates, or suggesting that members file or adhere to any proposed tariff that affects rates.<sup>263</sup> The order also requires the association to cancel all current filed tariffs affecting rates within 120 days and to amend its by-laws to require member carriers to abide by the provisions of the order.<sup>264</sup>

Because the case was resolved by consent order, rather than a trial on the merits, the association did not raise a state action defense and the issue was not litigated. The Commission did, however, take the opportunity to provide a detailed explanation of its views on the "active supervision" requirement in the Analysis to Aid Public Comment that accompanied the

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<sup>262</sup> *Indiana Household Movers and Warehousemen, Inc.*, Docket No. C-4077, at ¶ 7(A) (Apr. 25, 2003) (complaint) available at <<http://www.ftc.gov/os/2003/04/ihtmwcmp.htm>>.

<sup>263</sup> *Indiana Household Movers and Warehousemen, Inc.*, Docket No. C-4077, at ¶ II. (Apr. 25, 2003) (consent order) available at <<http://www.ftc.gov/os/2003/04/ihtmwo.htm>>.

<sup>264</sup> *Id.* at ¶ III.

complaint and consent order.<sup>265</sup> While acknowledging that “the Supreme Court’s standard for active supervision . . . is and will remain the ultimate test for that element of state action immunity,”<sup>266</sup> the Commission endeavored to use the Analysis to provide the Bar with guidance on an issue at the heart of its institutional expertise. As the document itself explains, “this Analysis identifies the specific elements of an active supervision regime that [the FTC] will consider in determining whether the active supervision prong of state action is met in future cases.”<sup>267</sup> Those elements are: (1) the development of an adequate factual record, including notice and an opportunity to be heard; (2) a written decision on the merits; and (3) a specific assessment – both qualitative and quantitative – of how private action comports with the substantive standards established by the state legislature.<sup>268</sup>

## 2. Additional Household Goods Movers Cases

In addition to the *Indiana Movers* case, Commission staff conducted investigations into allegations of similar joint rate-setting conduct by associations of household goods movers in Minnesota and Iowa. Both of these matters were resolved by consent order.<sup>269</sup> As in *Indiana Movers*, the Analyses to Aid Public Comment that accompanied the consent orders in these cases clarified that, because the state did not actively supervise the conduct in question, the state action doctrine did not shield the association from antitrust liability.<sup>270</sup>

In addition to the Minnesota and Iowa cases, the Commission recently filed complaints against associations of household good movers in Alabama, Kentucky, and Mississippi.<sup>271</sup> The

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<sup>265</sup> *Indiana Movers* Analysis, *supra* note 237.

<sup>266</sup> *Id.* at 5.

<sup>267</sup> *Id.*

<sup>268</sup> *Id.*

<sup>269</sup> *Minnesota Transport Services Ass’n*, Docket No. C-4097 (Sept. 15, 2003) (consent order) available at <<http://www.ftc.gov/os/2003/09/minnesotado.pdf>>; *Iowa Movers and Warehousemen’s Ass’n*, Docket No. C-4096 (Sept. 10, 2003) (consent order) available at <<http://www.ftc.gov/os/2003/09/iowamoversdo.pdf>>.

<sup>270</sup> *Minnesota Transport Services Ass’n*, File No. 021-0115 (Aug. 1, 2003) (Analysis to Aid Public Comment) available at <<http://www.ftc.gov/os/2003/08/mtsaanalysis.htm>>; *Iowa Movers and Warehousemen’s Ass’n*, File No. 021-0115 (Aug. 1, 2003) (Analysis to Aid Public Comment) available at <<http://www.ftc.gov/os/2003/08/imwaananalysis.htm>>.

<sup>271</sup> *Alabama Trucking Ass’n, Inc.*, Docket No. 9307 (July 8, 2003) (complaint) available at <<http://www.ftc.gov/os/2003/07/aladmincmp.pdf>>; *Kentucky Household Goods Carriers Ass’n, Inc.*, Docket No. 9309 (July 8, 2003) (complaint) available at



Alabama and Mississippi cases have been withdrawn from adjudication pending consent order negotiations.<sup>272</sup> The Kentucky case, in contrast, is currently being litigated.

## **B. Competition Advocacy**

The Commission has also addressed state action issues through competition advocacy. This type of project has always been a part of the Commission's arsenal, but may be of particular importance in the state action context because of the need to deal with independent sovereignties. The Commission and its staff undertake advocacy projects at the invitation of state policymakers; such projects may operate in either of two broad ways. In some cases, a state government is the effective decision-maker, and the Commission's efforts are directed toward helping the state to assess the impact of a particular regulatory action on competition and consumers. In other cases, private consumers – or their proxies – are the effective decision-makers, and the Commission's efforts are directed toward public education. These efforts have typically involved raising the profile of a particular issue so that ordinary market mechanisms can thereafter correct any problem that might exist. In many instances, competition advocacy essentially serves as a means for the Commission to communicate antitrust concerns to state governments that would otherwise be communicated only through litigation (which, in turn, would raise significant state action issues).

### **1. Antitrust Exemptions for Physician Collective Bargaining**

In the past several years, a number of legislators have asked the Commission to comment on draft state legislation that would create an antitrust exemption for physician collective bargaining. In some instances, the state legislators have specifically requested that the Commission offer an opinion as to whether collective bargaining conducted under the auspices of the legislation would be shielded by the state action doctrine. In other instances, they have merely requested that the Commission provide its views on whether the legislation is in the best interest of consumers.

The FTC has long been on record as opposing broad and unnecessary extensions of the

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<<http://www.ftc.gov/os/2003/07/ktadmincmp.pdf>>; Movers Conference of Mississippi, Inc., Docket No. 9308 (July 8, 2003) (complaint) available at <<http://www.ftc.gov/os/2003/07/msadmincmp.pdf>>.

<sup>272</sup> Alabama Trucking Ass'n, Inc., Docket No. 9307 (Aug. 29, 2003) (order withdrawing matter from adjudication) available at <<http://www.ftc.gov/os/adjpro/d9307/030829orderwithdrawconsidstlmnt.pdf>>; Movers Conference of Mississippi, Inc., Docket No. 9308 (Aug. 12, 2003) (order withdrawing matter from adjudication) available at <<http://www.ftc.gov/os/adjpro/d9308/030812orderwthdrawfromadjud.pdf>>.



state action doctrine in such situations.<sup>273</sup> Thus, when asked recently to comment on physician collective bargaining bills in Ohio, Washington, and Alaska, Commission staff reiterated and emphasized well-established principles. In each instance, staff of the Bureau of Competition and the Office of Policy Planning – and, in the case of the Washington bill, the Northwest Regional Office – noted that an antitrust exemption: (i) would authorize physician price fixing, which is likely to raise costs and reduce access to care; and (ii) would *not* improve the quality or care, which can be accomplished through less anticompetitive means.<sup>274</sup>

In each instance, the critical state action issue raised was whether the oversight regime created by the bill satisfied the “active supervision” requirement. In the course of articulating broader antitrust concerns about the proposed legislation, and specific failings under the state action doctrine, staff were also able to suggest more robust active supervision standards as potential improvements to the bill. In particular, staff observed that the requirement of a “written decision, expressly considering the potentially anticompetitive implications of a proposed contract and attempting to quantify the consumer impact and expected effect on consumer prices”<sup>275</sup> – especially issued after public notice and opportunity to comment – would increase the likelihood of a finding of active supervision.

The reactions of state legislatures to the staff’s advocacy letters have been varied but, in large part, positive. The Alaska legislature, for example, requested additional information, which FTC staff provided in the form of testimony before the House Committee on Labor and Commerce.<sup>276</sup> The Alaska legislature subsequently passed the draft bill, but not before striking language expressly stating that the bill was intended to authorize collective negotiations “over

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<sup>273</sup> See, e.g., Letter to the District of Columbia Office of Corporation Counsel on Bill No. 13-333 (Oct. 29, 1999) available at <<http://www.ftc.gov/be/rigsby.htm>>; Testimony of the Federal Trade Commission before the House Judiciary Committee on H.R. 1304 (June 22, 1999) available at <<http://www.ftc.gov/os/1999/9906/healthcaretestimony.htm>>; Letter to the Texas Legislature on Senate Bill 1468 (May 13, 1999) available at <<http://www.ftc.gov/be/v990009.htm>>.

<sup>274</sup> See Letter to the Ohio House of Representatives on House Bill 325 (Oct. 16, 2002) available at <<http://www.ftc.gov/be/v020017.pdf>>; Letter to the Washington House of Representatives on House Bill 2360 (Feb. 8, 2002) available at <<http://www.ftc.gov/be/v020009.pdf>>; Letter to the Alaska House of Representatives on Senate Bill 37 (Jan. 18, 2002) (“Alaska Letter”) available at <<http://www.ftc.gov/be/v020003.htm>>.

<sup>275</sup> Alaska Letter, *supra* note 274, at 14.

<sup>276</sup> See, e.g., Testimony of the Staff of the Bureau of Competition and the Office of Policy Planning before the Committee on Labor and Commerce of the Alaska House of Representatives on S.B. 37 (March 22, 2002) available at <<http://www.ftc.gov/be/hilites/cruz020322.htm>>.



fee-related terms.” In contrast, the Washington legislature withdrew its draft bill from consideration in light of the staff comment. In place of the bill, the legislature substituted a resolution calling for appointment of a commission to study the issue.

## 2. Prohibitions on Non-Lawyer Participation in Real Estate Closings

Several states, either directly or through state bar associations, are considering whether non-lawyers should be permitted to conduct closings for real estate transactions and mortgage loans. In the past, the FTC and the Antitrust Division of the Department of Justice have jointly pointed out the anticompetitive consequences of rules that prevent nonlawyers from conducting closings. The consequences are even more significant now, because they make it more difficult for national and Internet-based lenders to compete in local mortgage lending markets. Local banks and mortgage companies are usually not subject to these costly rules because the rules typically do not apply to lenders that perform their own loan closings; regulation thus confers on them an advantage over lenders that do not have offices in the state. The FTC’s primary contribution has been to assess the consumer impact of these rules, with a special focus on the differential impact on interstate and Internet commerce.

Toward that end, in conjunction with Antitrust Division, the Commission recently filed letters in North Carolina, Georgia, and Rhode Island raising concerns about proposed restrictions on who may participate in loan closings.<sup>277</sup> In North Carolina, a proposed State Bar opinion required the physical presence of an attorney at all residential loan closings, including simple refinancings. The Georgia State Bar considered an opinion that would effectively prevent nonlawyers from closing real estate transactions and mortgage loans. In Rhode Island, a proposed bill contained even more restrictive requirements. All of these proposals would raise costs for consumers, who would have to pay for additional services, while providing little additional consumer protection. Such proposals may also impede competition from out-of-state Internet lenders, since in many cases in-state corporations are permitted to close loans without attorneys.

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<sup>277</sup> See FTC/DOJ Letter to the Rhode Island House of Representatives re: Proposed Restrictions on Competition From Non-Attorneys in Real Estate Closing Activities (Mar. 28, 2003) available at <<http://www.ftc.gov/be/v020013.htm>>; FTC/DOJ Letter to the Standing Committee on the Unlicensed Practice of Law, State Bar of Georgia (Mar. 20, 2003) available at <<http://www.ftc.gov/be/v030007.htm>>; FTC/DOJ Letter to the President of the North Carolina State Bar re: Proposed North Carolina State Bar Opinions Concerning Non-Attorneys’ Involvement in Real Estate Transactions (July 11, 2002) available at <<http://www.ftc.gov/os/2002/07/non-attorneyinvolvement.pdf>>; FTC/DOJ Letter to the Rhode Island House of Representatives re: Bill Restricting Competition from Non-Attorneys in Real Estate Closing Activities (Mar. 29, 2002) available at <<http://www.ftc.gov/be/v020013.pdf>>; FTC/DOJ Letter to the Ethics Committee of the North Carolina State Bar re: State Bar Opinions Restricting Involvement of Non-Attorneys in Real Estate Closings and Refinancing Transactions (Dec. 14, 2001) available at <<http://www.ftc.gov/be/v020006.htm>>.



The North Carolina Bar ultimately revised its rules to eliminate the requirement that attorneys closing loans be physically present at the closing, and the bar also opted to permit nonlawyers to witness signatures on documents and receive and disburse funds. The Rhode Island legislature declined to enact its bill in the 2003 session and is currently considering a similar measure.

In contrast, the Georgia State Bar ultimately adopted the proposed opinion, concluding that the preparation and facilitation of the execution of deeds of conveyance on behalf of another by anyone other than a duly licenced attorney constitutes the unlicensed practice of law. The matter is now before the Georgia Supreme Court on direct review. On July 28, 2003, the Commission and the Antitrust Division filed a joint *amicus* brief in that action raising the same objections set forth in the agencies' letter to the State Bar.<sup>278</sup>

### 3. Prohibitions on "Below Cost" Sales of Motor Fuels

In recent years, numerous states have considered "minimum markup" or "sales below cost" bills that would limit the ability of gasoline vendors to cut prices. Depending on market circumstances, these laws may diminish competition from integrated oil firms, convenience stores, or high-volume retailers. Bills on this topic are introduced and debated in many state legislatures almost every year.

At the invitation of state policymakers, FTC staff have often offered comments on proposed bills addressing these topics. In the past two years, for example, FTC staff have submitted comments on "sales below cost" bills in North Carolina<sup>279</sup> and Virginia,<sup>280</sup> and have submitted comments on two different "sales below cost" bills in New York.<sup>281</sup> Although the bills differed in some particulars, in each instance FTC staff concluded that these bills would likely harm consumers by deterring procompetitive price cutting. The staff's comments also noted that

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<sup>278</sup> *On Review of UPL Advisory Opinion No. 2003-2, Brief Amici Curiae of the United States of America and the Federal Trade Commission (July 28, 2003) available at <<http://www.ftc.gov/os/2003/07/georgiabrief.pdf>>.*

<sup>279</sup> Letter to the Attorney General of North Carolina on House Bill 1203 / Senate Bill 787 (May 19, 2003) ("North Carolina Letter") available at <[http://www3.ftc.gov/os/2003/05/nccllattorneygeneral\\_cooper.pdf](http://www3.ftc.gov/os/2003/05/nccllattorneygeneral_cooper.pdf)>.

<sup>280</sup> Letter to the Virginia House of Delegates on Senate Bill No. 458 (Feb. 15, 2002) available at <<http://www.ftc.gov/be/v020011.htm>>.

<sup>281</sup> Letter to the Attorney General of New York on Bill No. S.4947 and Bill No. A.8398 (July 24, 2003) available at <<http://www.ftc.gov/be/nymfmpa.pdf>>; Letter to the Governor of New York on Bill No. S04522 and Bill No. A06942 (Aug. 8, 2002) available at <<http://www3.ftc.gov/be/v020019.pdf>>



low prices benefit consumers, and that consumers are harmed only if low prices allow a dominant competitor to raise prices later to supracompetitive levels. Moreover, the comments noted, scholarly studies indicate that below-cost pricing that leads to monopoly rarely occurs, and the Supreme Court has found such studies to be credible.<sup>282</sup> In particular, past studies suggest that below-cost sales of motor fuels that lead to monopoly are especially unlikely.<sup>283</sup> Finally, the comments concluded that the bills were unnecessary, because the federal antitrust laws deal with below-cost pricing that has a dangerous probability of leading to monopoly.<sup>284</sup>

In North Carolina, the bill remains pending before the relevant Senate committee. In Virginia, the relevant House committee rejected the bill. In New York, Governor Pataki vetoed the first bill, and the second bill is currently awaiting his decision.

#### 4. Restrictions on Sales of Contact Lenses

In March 2002, Commission staff filed a comment with the Connecticut Board of Examiners for Opticians, arguing against the adoption of a requirement that Internet sellers of replacement contact lenses have a Connecticut optician's license, even though such sellers merely mail out pre-packaged lenses pursuant to an eye doctor's prescription.<sup>285</sup> The staff concluded that such a requirement would likely increase consumer costs while producing no offsetting health benefits and would be a barrier to the expansion of Internet commerce. Indeed, such licensing could harm public health by raising the cost of replacement contact lenses, inducing consumers to replace the lenses less frequently than doctors recommend or to substitute other forms of contact lenses that pose greater health risks. The staff also noted that current federal and state prescription requirements and consumer protection laws are sufficient to address the health problems associated with contact lens use, but that such requirements can be implemented in ways that are either procompetitive or anticompetitive. The FTC staff urged the Board to implement the prescription requirement in a way that protects consumers' health, promotes competition, and maximizes consumer choice.

Ultimately, the staff comment was successful. The Board held hearings in June and October of 2002. On June 24, 2003, the Board issued a memorandum decision holding that: (1) opticians and optical establishments located in Connecticut must be licensed by the state to sell contact lenses; (2) contact lens sellers located outside of Connecticut that sell lenses to

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<sup>282</sup> See, e.g., North Carolina Letter at 8-9.

<sup>283</sup> See *id.* at 9-11.

<sup>284</sup> See *id.* at 5-8.

<sup>285</sup> Comments of the Staff of the Federal Trade Commission, Intervenor, before the Connecticut Board of Examiners for Opticians (Mar. 27, 2002) available at <<http://www.ftc.gov/be/v020007.htm>>.



Connecticut residents need not obtain a Connecticut license; and (3) contact lens sellers, whether within or without the state, may sell contact lenses only pursuant to a lawfully issued prescription.<sup>286</sup> The Board did not specify what constituted a lawfully issued prescription.

## 5. Restrictions on Sales of Funeral Caskets

On August 29, 2002, the Commission filed an *amicus* brief in *Powers v. Harris* – a case before the Western District of Oklahoma in which an Internet-based casket seller challenged a state law requiring all sellers of funeral goods to be licensed funeral directors.<sup>287</sup> Plaintiffs' principal claim in *Powers* was that a provision of the Oklahoma Funeral Services Licensing Act ("FLSA") that required sellers of funeral goods, including caskets, to be licensed funeral directors violated the Commerce Clause. The Funeral Board defended the constitutionality of the provision by arguing that it was rationally related to a legitimate state interest: the protection of Oklahoma consumers. In support of this consumer protection rationale, the Board asserted that the objectionable FLSA provision advanced the same objectives as the FTC's Funeral Rule. While declining to take a position on the underlying Commerce Clause issue, the Commission filed a brief for the sole purpose of explaining the purpose and operation of the Funeral Rule which, unlike the FLSA provision, is intended to *increase* competition. The Commission's brief stated that the FTC's Funeral Rule was adopted, at least in part, to open casket sales to competition from sellers other than funeral directors, and that the Rule protects consumers by promoting competition among providers of funeral goods, including independent on-line casket retailers.<sup>288</sup> Ultimately, the court concluded that the Oklahoma provision satisfied the rational basis test.<sup>289</sup> In reaching this conclusion, however, the court distinctly did *not* accept the Board's argument that the FLSA provision was merely an extension of the FTC's Funeral Rule.

## 6. Other Restrictions on E-Commerce

The State Action Task Force also spawned a spin-off task force focused on Internet issues. That task force is carefully evaluating the presence and growth of state regulatory barriers to the expansion of e-commerce. In the past decade, there has been growing concern about possibly anticompetitive efforts to restrict competition on the Internet. In particular, many states

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<sup>286</sup> *In re Petition for Declaratory Ruling Concerning Sales of Contact Lenses*, slip op. at 5-8 (Conn. Bd. of Examiners for Opticians June 24, 2003)

<sup>287</sup> *Powers v. Harris*, Memorandum of Law of *Amicus Curiae* The Federal Trade Commission (Aug. 29, 2002) available at <<http://www.ftc.gov/os/2002/09/okamicus.pdf>>.

<sup>288</sup> *Id.* at 1.

<sup>289</sup> See *Powers v. Harris*, No. CIV-01-445-F (W.D. Okla. Dec. 12, 2002). *But see* *Craigmiles v. Giles*, 312 F.3d 220 (6th Cir. 2002) (holding that a very similar Tennessee provision did *not* satisfy the rational basis test).



have enacted regulations that have the direct effect of protecting local merchants from competition over the Internet. For example, some states require that online vendors maintain an in-state office, while other states prohibit online sales of certain products entirely. Some scholars have argued that these regulations are often simply attempts by existing industries to forestall the entry of new and innovative Internet competitors, much as entrenched producers in prior eras benefitted from regulatory efforts to impede new forms of competition.

Depending on the circumstances, some of these restrictions could be viewed as potentially anticompetitive. While much of this regulation undoubtedly has procompetitive and pro-consumer rationales, it imposes costs on consumers that, according to some estimates, may exceed \$15 billion annually.<sup>290</sup>

For these reasons, on October 8-10, 2002, the Commission hosted a workshop, organized by the Office of Policy Planning, to address possible anticompetitive efforts to restrict competition on the Internet.<sup>291</sup> The workshop was intended to enhance the Commission's understanding of particular practices and regulations, and endeavored to build upon previous FTC-sponsored events addressing other aspects of e-commerce.<sup>292</sup> The workshop solicited input from a broad range of perspectives, including the views of on-line businesses, their brick-and-mortar competitors, consumer advocates, and academics with expertise in both economics and business management. The workshop also featured substantial participation from state regulators, ranging from members of industry-specific boards of professional licensure to a current state Attorney General and a former Governor.

In order to gain a better understanding of the potential regulatory barriers facing Internet competitors in particular industries, the workshop convened panels of experts to address: (1) wine sales; (2) cyber-charter schools; (3) contact lenses; (4) automobiles; (5) casket sales; (6) online legal services; (7) telemedicine and online pharmaceutical sales; (8) auctions; (9) real estate, mortgages, and financial services; and (10) retailing. The workshop also offered an opportunity to highlight the past efforts of the Internet Task Force in some of these areas, including recent competition advocacy comments addressing real estate closings, contact lens sales and casket sales. Furthermore, the work of the Task Force attracted the attention of

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<sup>290</sup> See Robert D. Atkinson, *The Revenge of the Disintermediated: How the Middleman Is Fighting E-Commerce and Hurting Consumers* at 2 (Jan. 2001) available at <<http://www.ppionline.org/documents/disintermediated.pdf>>.

<sup>291</sup> See Federal Trade Commission, Public Workshop, *Possible Anticompetitive Efforts to Restrict Competition on the Internet* (Oct. 8-10, 2002) (workshop home page) available at <<http://www.ftc.gov/opp/ecommerce/anticompetitive/index.htm>>.

<sup>292</sup> For more information on previous FTC-sponsored events regarding e-commerce, see <<http://www.ftc.gov/opp/ecommerce/index.htm>>; <<http://www.ftc.gov/opa/2000/05/b2bworkshop.htm>>.



Congress, which invited the Commission to testify before the Subcommittee on Commerce, Trade, and Consumer Protection of the House Energy and Commerce Committee.<sup>293</sup>

Ultimately, the Internet Task Force anticipates submitting to the Commission one or more additional reports describing the nature and prevalence of barriers to e-commerce and the potential effects of such barriers on consumers. The Task Force also intends to provide recommendations regarding potential strategies to promote greater competition and expanded commerce on the Internet. The first report of the Internet Task Force, analyzing online wine sales, was released on July 3, 2003.<sup>294</sup>

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<sup>293</sup> Testimony of the Federal Trade Commission before the Subcommittee on Commerce, Trade, and Consumer Protection of the House Energy and Commerce Committee on Possible State Impediments to E-Commerce (Sept. 26, 2002) available at <http://www.ftc.gov/os/2002/09/020926testimony.htm>.

<sup>294</sup> See *Possible Anticompetitive Barriers to E-Commerce: Wine* (July 2003) available at <http://www.ftc.gov/os/2003/07/winereport2.pdf>.





# Federal Trade Commission

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**So I Serve as Both a Prosecutor and a Judge – What’s the Big Deal?**

**Remarks of J. Thomas Rosch\***  
**Commissioner, Federal Trade Commission**

**before the**

**American Bar Association Annual Meeting**

**San Francisco, California**

**August 5, 2010**

Good afternoon. To get our conversation started, I’ve been asked to make some initial remarks about the FTC’s role as both prosecutor and judge. I will focus my remarks on three issues: (1) the standard that the Commission applies when, acting as a prosecutor, it votes out a complaint; (2) the standards that the Commission applies when, sitting as an appellate tribunal, it reviews decisions from Administrative Law Judges (ALJs); and (3) whether and to what extent there is anything untoward about the Commission occupying both of these prosecutorial and adjudicative roles.

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\* The views stated here are my own and do not necessarily reflect the views of the Commission or other Commissioners. I am grateful to my attorney advisor, Amanda Reeves, for her invaluable assistance in preparing this paper.



## I.

When I first came to the Commission in 2006, I was, to put it politely, underwhelmed by our litigation efforts. I didn't think we were aggressive enough. I am happy to say that over the last 4.5 years, that has changed. The Commission is suing and litigating as an active prosecutor should. Since January 2009, for example, the Commission has been extraordinarily active, filing litigation in six competition matters,<sup>1</sup> entering into more than two dozen consent decrees,<sup>2</sup> and continuing to litigate a number of other competition matters initiated during the Bush administration.<sup>3</sup> All of this means that the Commission more and more is grappling with the "reason to believe" standard, which, by statute,<sup>4</sup> is the standard that the Commission applies when it acts as a prosecutor and decides to vote out a complaint; if we have a "reason to believe" that anticompetitive conduct is occurring, we can sue. I'd like to begin by offering some thoughts on that standard.

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<sup>1</sup> The FTC challenged the CSL/Talecris and Thoratec/Heartware unconsummated mergers, the Carilion and Dun & Bradstreet consummated mergers, a pay-for-delay pharmaceutical settlement involving Androgel, and certain business practices of Intel. A compilation of the FTC's enforcement actions is available at <http://www.ftc.gov/bc/caselist/index.shtml>.

<sup>2</sup> The consent decrees were in the Transitions Optical, Boulder Valley, West Penn MLS, Amerco/Avis, Minnesota Rural Health Cooperative, Intel, Roaring Fork, Alta Bates, and National Association of Music Merchants conduct cases and the following merger cases: Dow/Rohm & Haas, Getinge/Datascope, Lubrizol/Lockhart, BASF/Ciba, K&S/Dow, Pfizer/Wyeth, Schering-Plough/Merck, Panasonic/Sanyo, SCI/Palm, Watson/Arrow, Agrium/CF, Danaher/MDS, Pepsi Bottling, SCI/Keystone, Agilent/Varian, and Flying J/Pilot.

<sup>3</sup> This litigation included the FTC's challenges to consummated acquisitions in the Ovation and Polypore matters, the unconsummated merger between CCC and Mitchell, and the Cephalon pharmaceutical pay-for-delay challenge.

<sup>4</sup> 15 U.S.C. § 45(b).

There is no statutory or regulatory definition regarding what it means to have a “reason to believe.” Moreover, attempts to litigate the issue of what the FTC must do to meet that standard have gone nowhere: in its 1980 decision in *FTC v. Standard Oil of California*, the Supreme Court held that the FTC’s application of the “reason to believe” standard in conjunction with voting out a complaint is not “final agency action” under the Administrative Procedure Act. Instead, the Court held, it is “a threshold determination that further inquiry is warranted” and, as such, is not subject to judicial review.<sup>5</sup> The “reason to believe” standard is therefore committed to each Commissioner’s discretion. In my own mind, when presented with the question of whether or not to vote out a complaint under this standard, I ask three questions drawing on the statute’s text. First, has the Bureau of Competition presented the Commission with enough evidence such that I can form a “reason to believe” that further investigation may as a factual and legal matter demonstrate liability? Second, is there a sound legal basis for the Bureau’s theory? And third, is pursuing litigation in the “public interest”?

When outside parties come in to argue that the Commission lacks a “reason to believe,” they tend to – errantly, in my view – focus primarily on the first question and argue that when all of the evidence is uncovered, they will prevail. The “reason to believe” standard, however, is not a summary judgment standard: it is a standard that simply asks whether there is a reason to believe that litigation may lead to a finding of liability. That is a low threshold.

In contrast, I am more likely to seriously question whether I can vote out a complaint under 13(b) if, as a matter of law, the FTC’s argument is foreclosed (in which

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<sup>5</sup> *FTC v. Standard Oil Co. of Cal.*, 449 U.S. 232, 241 (1980).



case it doesn't matter what evidence Complaint Counsel uncovers). Of course, a federal agency, like a private litigant, is entitled to advance claims based on "a nonfrivolous argument for extending, modifying, or reversing existing law or for establishing new law". Fed. R. Civ. P. 11(b)(2). Nevertheless, if a Commissioner believes that it is bad public policy to use Commission resources to advocate for such a change (perhaps because he/she does not agree with the change), that Commissioner may vote against the complaint. Likewise, perhaps the argument that is often the most persuasive to me yet is made with the least frequency is that voting out a complaint would not be in the public interest, as Section 5 requires. That could occur in any number of circumstances, including when we are challenging conduct that is causing minimal consumer harm, when the case will not establish an important proposition of law (or may even establish bad law), when there is no clear remedy, or when there are other arguments for why a case is a poor use of the Commission's finite resources.

As these observations suggest, the "reason to believe" standard is amorphous and can have an "I know it when I see it" feel. Nevertheless, I don't find its ambiguity to be troubling when you consider that the Commission's application of the "reason to believe" standard is not any more far afield than decisions made by other federal prosecutors. In the criminal context, a prosecutor needs "probable cause" to make an arrest, conduct a search, or obtain a warrant for an arrest, and a grand jury needs "probable cause" to vote out an indictment. Generally speaking, the Supreme Court has held that a prosecutor or grand jury has "probable cause" where "the known facts and circumstances are sufficient to warrant a man of reasonable prudence" that evidence of illicit conduct may be found –

i.e., when it has a reason to believe.<sup>6</sup> More to the point, the reason to believe standard is consistent with standards used by prosecutors (including the DOJ's Antitrust Division) in making prosecutorial decisions in civil cases. This is all to say that while there may be some logical critiques of the FTC's practice and procedures, I don't think the "reason to believe" standard or the deliberative process the FTC engages in to make that determination – which typically follows at least six months of investigation – is one of those.

## II.

Next I would like to discuss the flipside of my prosecutorial role, which is the Commission's role as an adjudicative tribunal. The most important issue in this context is the standard of review that the Commission applies when it considers appeals from decisions rendered by Administrative Law Judges (or, in Commission parlance, "Part 3 decisions"). Just last week the Commission heard oral argument in a competition case – *In re Polypore Int'l, Inc.* – which is an appeal from an ALJ decision that found that a consummated merger violated Section 7 of the Clayton Act.<sup>7</sup> As a result, these issues are ones that we are grappling with as we speak. Like any federal appellate tribunal, there are two categories of issues we must address: the standard that we should accord the ALJ's conclusions of law and the deference we should accord the ALJ's findings of fact.

The first issue is the easier one. It is well established that federal appellate courts review conclusions of law de novo.<sup>8</sup> Relative to federal appellate courts, there is

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<sup>6</sup> *Ornelas v. United States*, 517 U.S. 690, 695 (1996).

<sup>7</sup> *In re Polypore Int'l, Inc.*, Notice Scheduling Oral Argument, FTC Docket No. 9327 (June 28, 2010) (scheduling oral argument for July 28, 2010).

<sup>8</sup> *FTC v. Ind. Fed'n of Dentists*, 476 U.S. 447, 454 (1986).



arguably an even more powerful argument that the FTC, as an expert agency, should subject an ALJ's conclusions of law to de novo review. The FTC's experience dealing with the sorts of hard questions that tend to come up in the antitrust context provide it with the unique and important ability to opine on hard questions of law in the first instance when it issues a Part 3 decision. Our decisions in *Three Tenors* and *North Texas Specialty Physicians* are great illustrations.<sup>9</sup> In both cases, the FTC applied the truncated rule of reason analysis articulated in *Indiana Federation of Dentists*<sup>10</sup> (another FTC case) to deem the practices at issue "inherently suspect." And, in both cases, the D.C. Circuit and the Fifth Circuit, respectively, agreed and adopted the FTC's analysis.<sup>11</sup> Had these questions been presented to a federal district court in the first instance (as they would had the DOJ brought the case), it's unlikely that the court would have been open (let alone equipped) to applying a more novel form of analysis in the first instance. Yet because the FTC supplied the courts with a well-crafted roadmap, the FTC was able to introduce a different form of doctrinal analysis – and one, I might add, that provides more predictability – into antitrust law.

In contrast, I am squeamish about second-guessing an ALJ's findings of fact, especially when they are based on the credibility of witnesses. When federal appellate courts review district court decisions, they accept the district court's findings, including

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<sup>9</sup> *In re PolyGram Holding, Inc. (Three Tenors)*, FTC Docket No. 9298 (July 24, 2003) (Commission opinion), available at <http://www.ftc.gov/os/2003/07/polygramopinion.pdf>; *In re North Texas Specialty Physicians*, FTC Docket No. 9312 (Dec. 1, 2005) (Commission opinion), available at <http://www.ftc.gov/os/adjpro/d9312/051201opinion.pdf>.

<sup>10</sup> *Ind. Fed'n of Dentists*, 476 U.S. 447; See *also In re Mass. Bd. of Optometry*, 110 F.T.C. 549 (1988),

<sup>11</sup> *Polygram Holding, Inc. v. FTC*, 416 F.3d 29 (D.C. Cir. 2005); *N. Tex. Specialty Physicians v. FTC*, 528 F.3d 346, 370 (5th Cir. 2008).

its determination on issues of witness credibility, unless they are “clearly erroneous.”<sup>12</sup> When the Commission sits as an appellate tribunal, however, we are supposed to review the ALJ’s findings of fact under a de novo standard,<sup>13</sup> and the Commission’s factual findings are then evaluated under a “substantial evidence” standard.<sup>14</sup> This FTC’s application of the de novo standard is compelled by the Administrative Procedure Act as well as the FTC Act,<sup>15</sup> which give the agency all of the same powers that it would have had had it rendered the initial decision; these statutes therefore provide that the Commission’s – not the ALJ’s – findings of fact, are what matters for appellate review. De novo review by the Commission is also compelled by a well-developed body of case law that holds that the Commission – and, again, not the ALJ – is responsible for resolving conflicts of testimony.<sup>16</sup>

Whatever the law may be, I am not convinced that appellate courts agree that, as a doctrinal matter, the FTC should subject an ALJ’s findings of fact to a de novo review

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<sup>12</sup> Fed. R. Civ. P. 52(a)(6).

<sup>13</sup> See, e.g., *In re Realcomp II, Ltd.*, 2009 FTC LEXIS 250, \*37 at n.11 (Oct. 30, 2009).

<sup>14</sup> 15 U.S.C. § 21(c). The Supreme Court has interpreted this to mean that the Commission’s conclusion must be supported by “such relevant evidence as a reasonable mind might accept as adequate to support a conclusion.” *Consol. Edison Co. v. NLRB*, 305 U.S. 197, 217 (1938). In *Indiana Fed’n of Dentists*, the Supreme Court held that the FTC’s deferential standard is coextensive with the APA’s requirement that a court defer to an agency’s factual findings so long as they are supported by “substantial evidence.” 5 U.S.C. § 706(2)(E); *FTC v. Ind. Fed’n of Dentists*, 476 U.S. at 454 (holding that the standard of review under § 5(c) is “essentially identical” to the substantial evidence test); see also *Colonial Stores v. FTC*, 450 F.2d 733, 739-40 (5th Cir. 1971) (“The findings must stand unless they were wrong and they cannot be wrong – that is, reversibly wrong – if substantial evidence supports them.”).

<sup>15</sup> See 5 U.S.C. § 557(b); 15 U.S.C. § 45(b) & (c).

<sup>16</sup> *Goodman v. FTC*, 244 F.2d 584, 590 n.5 (9th Cir. 1957) (quoting *Bristol-Myers Co. v. FTC*, 185 F.2d 58, 62 (4th Cir. 1950)); *De Gorter v. FTC*, 244 F.2d 270, 272-73 (9th Cir. 1957) (citing *United States v. L.A. Tucker Truck Lines, Inc.*, 344 U.S. 33, 35-7 (1952)).



and that, more generally, they are always faithful to the substantial evidence standard. Why is that? In my view, the appellate courts' deference to the Commission's fact finding is, rightly or wrongly, bound up with their determination of whether the Commission correctly analyzed the question of law. In *Indiana Federation of Dentists*, the Supreme Court held that legal issues are "for the courts to resolve, although even in considering such issues the courts are to give some deference to the Commission's informed judgment that a particular commercial practice is to be condemned as 'unfair.'"<sup>17</sup> But, it seems very clear to me that when a Court wants to reject the Commission's conclusions as a matter of law, it reviews the Commission's analysis de novo and gives the Commission's factual findings little deference.

In *Schering-Plough*, for example, the Eleventh Circuit rejected the Commission's finding that a reverse payment settlement was anticompetitive. In so holding, the court took creative license with the substantial evidence standard, citing a Tenth Circuit case that preceded *Indiana Federation of Dentists* for the proposition that "we may . . . examine the FTC's findings more closely where they differ from those of the ALJ."<sup>18</sup> The Eleventh Circuit cited a pair of cases that preceded *Indiana Federation of Dentists* for the proposition that "[s]ubstantial evidence requires a review of the *entire* record at trial, and that most certainly includes the ALJ's credibility determinations and the overwhelming evidence that contradicts the Commission's conclusion."<sup>19</sup>

Likewise, in *Rambus*, the D.C. Circuit reversed the Commission's finding that computer chip manufacturer Rambus violated Section 5 of the FTC Act when it made

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<sup>17</sup> *Indiana Fed'n of Dentists*, 476 U.S. at 454.

<sup>18</sup> *Schering-Plough Corp. v. FTC*, 402 F.3d 1056, 1062 (11th Cir. 2005)

<sup>19</sup> *Schering-Plough*, 402 F.3d at 1070 (emphasis added).

misrepresentations to a private, standard-setting organization.<sup>20</sup> Tellingly, in my view, the D.C. Circuit reached a conclusion on the question on appeal before – almost as an afterthought – so much as mentioning the deference that should be accorded to the Commission’s factual findings.<sup>21</sup> Not surprisingly, the D.C. Circuit found those findings were based on “rather weak evidence.”<sup>22</sup> In contrast, in those cases where the appellate court has affirmed the FTC, it has been very deferential towards our factual findings.<sup>23</sup>

All of this has led me to conclude that the Commission should be very cautious when – if ever – it rejects the ALJ’s factual findings and, more particularly, its assessment of witness credibility. The Commission does not hear the live testimony, and understandably I think, if an appellate court is looking for reasons to reverse the Commission, given that appellate courts do not generally do a *de novo* review of facts in other cases, they probably find it odd that the Commission gets to do just that. As such, whatever the law may require, I don’t think that the appellate courts tend to look

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<sup>20</sup> *Rambus Inc. v. FTC*, 522 F.3d 456 (D.C. Cir. 2008).

<sup>21</sup> *Id.* at 442. The Court stated, “[w]e hold, therefore, that the Commission failed to demonstrate that Rambus’s conduct was exclusionary, and thus to establish its claim that Rambus unlawfully monopolized the relevant markets.” *Id.* Only after making that finding did the Court then separately analyze the deference owed to the Commission’s fact finding.

<sup>22</sup> *Id.* at 469.

<sup>23</sup> In the *Toys ‘R Us* litigation, for example, the Seventh Circuit affirmed the FTC. In so holding, the Seventh Circuit observed that “[o]ur only function is to determine whether the Commission’s analysis of the probable effects of these acquisitions . . . is so implausible, so feebly supported by the record, that it flunks even the deferential test of substantial evidence.” *Toys ‘R Us v. FTC*, 221 F.3d 928, 934-35 (7th Cir. 2000) (quoting *Hospital Corp. of America v. FTC*, 807 F.2d 1381, 1385 (7th Cir. 1986)). Likewise, in *Polygram Holding*, the D.C. Circuit affirmed the Commission’s finding that PolyGram Holding violated Section 5 of the FTC Act by entering into a series of agreements that prohibited discounts and advertising. *Polygram Holding, Inc. v. FTC*, 416 F.3d 29 (D.C. Cir. 2005). In its discussion of the legal standard it cited the *Indiana Federation of Dentists* test and the substantial evidence standard, which it later concluded that the Commission had met. *Id.* at 38.



deferentially on our decision to depart from the ALJ's findings of fact. As such, as a strategic matter, I don't think we should be giving them any extra ammunition to reverse us.

Apart from these issues, a second more esoteric, but potentially equally important, topic relating to our role as an adjudicative tribunal is what happens when the Commission is not operating at full strength (i.e., with fewer than five Commissioners). This can occur when a Commissioner is recused from a matter due to a prior employment or financial conflict, but it also can occur when there is an unfilled vacancy. From March 2008 to March 2010, for example, the FTC functioned with just four members (and without a partisan majority, with one Democrat, one Independent, and two Republicans).

From a good government standpoint, it is of course better when the Commission sits as an appellate tribunal and operates at full strength. One of the institutional arguments for why the FTC is perhaps superior to agencies that are not independent (like, for example, the Department of Justice), is premised on the Commission's structure. The FTC is headed by five Commissioners that serve staggered 7-year terms, no more than three of which can be from the same political party.<sup>24</sup> On a day-to-day basis, the need to create a majority forces the Commissioners to consider one another's views.<sup>25</sup> As I have

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<sup>24</sup> 15 U.S.C. § 41.

<sup>25</sup> As former Commissioner Leary observed, "[w]hen we deal with shades of gray" – as we often do – "the process is likely to produce better outcomes. It certainly nudges people toward the center." Thomas B. Leary, Commissioner, Fed. Trade Comm'n, "The Bipartisan Legacy" (May 8, 2003), *available at* <http://www.ftc.gov/speeches/leary/050803bipartisanlegacy.pdf>.

previously observed,<sup>26</sup> this structure means that the FTC as a decision-making body is less vulnerable to the political swings that the Antitrust Division is inevitably subject to. If we are only operating with two or three Commissioners, those justifications are less persuasive.

As the Supreme Court made clear in June, however, in *New Process Steel v. NLRB*,<sup>27</sup> a five-member independent agency or commission that sits (for whatever reason) with only two decision makers, may not have lawful authority to act. During a 27-month period from January 1, 2008 to March 27, 2010, there were just two NLRB Board members (from opposite political parties, I might add) who together decided almost 600 cases.<sup>28</sup> The other three seats sat vacant. New Process Steel received an unfavorable decision from the Board during this period and sued, claiming the NLRB's enabling statute did not authorize the Board to delegate its powers to a two-member quorum. Although the Seventh Circuit sided with the NLRB,<sup>29</sup> the Supreme Court in a 5-4 decision did not. As a result, the Board was forced to vacate all of its decisions during this 27-month period.

As you can imagine, this case gave me serious heartburn when I first learned of it. I am happy to report that I have been assured by our General Counsel that in 2005, the FTC promulgated a rule (pursuant to statutory authority that differs from the NLRB's)

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<sup>26</sup> J. Thomas Rosch, "Rewriting History: Antitrust Not as We Know It . . . Yet," Remarks before ABA Antitrust Section Spring Meeting (April 23, 2010), *available at* <http://www.ftc.gov/speeches/rosch/100423rewritinghistory.pdf>.

<sup>27</sup> 130 S. Ct. 2635 (2010).

<sup>28</sup> *Id.* at \*7-8.

<sup>29</sup> *New Process Steel v. NLRB*, 564 F.3d 840 (7th Cir. 2009).



that provides that a two-member FTC can serve as a quorum if circumstances require.<sup>30</sup>

This means that in those instances when we are forced to act with just two

Commissioners, we are acting lawfully. *New Process Steel*, however, was certainly a wake-up call to Boards and Commissions around Washington.

### III.

Finally, I would like to turn to the most controversial issue and that is whether there is anything problematic about combining the prosecutorial and adjudicative functions, as Congress did when it created the FTC. To put a finer point on it: as a matter of law, is there something wrong with the Commission acting as a prosecutor when it votes out a complaint and then sitting as an independent tribunal when it considers an appeal following a trial before an ALJ?

Congress apparently didn't think so. When it established the FTC in 1914, it intended for the FTC to serve the dual roles of prosecutor and judge<sup>31</sup> – a view that it

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<sup>30</sup> 16 C.F.R. § 4.14 (2010). *See also* 70 Fed. Reg. 173, 53296-97 n. 3 (citing *Falcon Trading Group v. SEC*, 102 F.3d 579 (D.C. Cir. 1996) (upholding a similar SEC rule providing that where the number of Commissioners in office is less than three, a quorum shall consist of the number of members in office who are not recused)).

<sup>31</sup> As Representative Covington, who authored the original bill to create the FTC, declared in 1914:

The function of the Federal Trade Commission will be to determine whether an existing method of competition is unfair, and if it finds it to be unfair, to order discontinuance of its use. In doing this, it will exercise power of a judicial nature....It would seem clear that the determination of the question whether a method of competition is unfair is not a determination purely of fact, but necessarily involves the determination of a question of law. The Federal Trade Commission will, it is true, have to pass upon many complicated issues of fact, but the ultimate question for decision will be whether the facts found constitute a violation of law against unfair competition. In deciding that ultimate question the Commission will exercise power of a judicial nature...

codified in Section 5 of the FTC Act.<sup>32</sup> At that time, as parties vociferously pointed out, there were problems from a due process perspective with the way the agency functioned. Hearing officers were typically subordinate employees of the agency who could be hired and fired based on their decisions and there was no internal separation required between the Commission and the hearing process.<sup>33</sup>

In 1946, however, Congress enacted the Administrative Procedure Act. As the Supreme Court has since observed, the APA's fundamental purpose was "to curtail and change the practice of embodying in one person or agency the duties of prosecutor and judge . . . . [T]he safeguards it did set up were intended to ameliorate the evils from the commingling of functions..."<sup>34</sup> To that end, the APA requires that independent administrative law judges (who are no longer subject to agency control) conduct the initial hearings and that the Commission then handle appeals. The APA prohibits agency employees who participate in the investigative or prosecutorial functions from playing a role in the decision-making process.<sup>35</sup> This structure has been subject to constitutional attacks on two fronts.

First, parties have claimed that lodging the legislative, prosecutorial, and judicial functions in one agency violates their due process -- a claim that has repeatedly fallen on

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51 Cong. Rec. 15, 14931-33 (1914).

<sup>32</sup> 15 U.S.C. § 45. Section 5 empowers the FTC to issue a complaint when it has "reason to believe" that an unfair method of competition or an unfair or deceptive act or practice has occurred. Then, after a hearing, Section 5 further empowers the FTC to make "findings as to the facts" and to issue a "cease and desist" order against any such violation.

<sup>33</sup> Administrative Conference of the United States, Rec. 80-1 & Rep. In Supp. Of Rec. 80-1 (1980).

<sup>34</sup> *Wong Yang Sung v. McGrath*, 339 U.S. 33, 41, 46 (1950).

<sup>35</sup> 5 U.S.C. § 554(d).



deaf ears. Thus, in 1948 the Supreme Court held that the mere fact that the Commission members had previously testified before Congress about the legality of a party's pricing scheme did not disqualify the Commissioners from providing a fair tribunal in a subsequent investigation of that same party.<sup>36</sup> Likewise, in 1975, the Supreme Court rejected a claim that a state agency's power to investigate and adjudicate the same matter was a due process violation, observing that, "[t]he initial charge or determination of probable cause and the ultimate adjudication have different bases and purposes. The fact that the same agency makes them in tandem and that they relate to the same issues does not result in a procedural due process violation."<sup>37</sup>

These decisions have not stopped parties from arguing that the FTC's procedures violated their due process rights. In *Inova/Prince William*, the Commission challenged a merger between the only two hospitals in the relevant geographic market.<sup>38</sup> The

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<sup>36</sup> *FTC v. Cement Inst.*, 333 U.S. 683 (1948).

<sup>37</sup> *Winthrow v. Larkin*, 421 U.S. 35, 58 (1975). The federal appellate courts have likewise repeatedly recognized that, by functioning in a quasi-prosecutorial, quasi-judicial dual role, the FTC does not violate litigants' procedural due process. *See, e.g., Cinderella Career & Finishing Schools, Inc.*, 404 F.2d 1308, 1315 (D.C. Cir. 1968) (holding that the Commission did not violate a party's due process rights by issuing a press release that was critical of the party's conduct following the issuance of a complaint, noting that "[i]t is well settled that a combination of investigative and judicial functions within an agency does not violate due process"); *Kennecott Copper Corp. v. FTC*, 467 F.2d 67, 79 (10th Cir. 1972) (rejecting Kennecott's argument that the Commission could not give it a fair hearing because of the Commission's extensive prior contacts with Congress on the subject matter at issue in the appeal and explaining that Congress designed the FTC to combine the functions of investigator, prosecutor, and judge and that "the courts have uniformly held that this feature does not make out an infringement of the due process clause of the Fifth Amendment").

<sup>38</sup> *In re Inova Health Sys. Found.*, FTC Docket No. 9326 (May 8, 2008) available at <http://www.ftc.gov/os/adjpro/d9326/080509admincomplaint.pdf>.



Commission appointed me to serve as the ALJ and oversee the trial,<sup>39</sup> and I recused myself from the Commission's decision to vote out a complaint. Notwithstanding my recusal, the parties claimed that because I had participated in the investigation (with my prosecutorial hat on) my appointment as a judge violated their due process rights and requested that I recuse myself from participating as ALJ.<sup>40</sup> The parties abandoned the merger before the Commission ruled on the motion.<sup>41</sup> Similarly, in the *Whole Foods* litigation, the Commission again appointed me to serve as the ALJ.<sup>42</sup> Whole Foods sued the FTC in federal court,<sup>43</sup> claiming that the FTC's prejudgment of the case along with its

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<sup>39</sup> See Press Release, FTC, FTC Designates Commissioner J. Thomas Rosch as ALJ in Case Challenging Inova Health System Foundation's Acquisition of Prince William Health System, Inc. (May 9, 2008), *available at* <http://www.ftc.gov/opa/2008/05/inovafyi.shtm>; Order Designating Administrative Law Judge, FTC Docket No. 9326 (May 9, 2008), *available at* <http://www.ftc.gov/os/adjpro/d9326/080509order.pdf>. Agency rules allowed the FTC to do so. Rules of Practice for Adjudicative Proceedings, 16 C.F.R. § 3.42(a) (2010).

<sup>40</sup> Respondents' Motion to Recuse Commissioner J. Thomas Rosch as Administrative Law Judge ("Respondents' Motion to Recuse") (May 23, 2008) *available at* <http://www.ftc.gov/os/adjpro/d9326/080523respmorecuseroschasalj.pdf>.

<sup>41</sup> Press Release, Inova Health System, Statement from Inova Health System and Prince William Health System About the Proposed Merger (June 6, 2008) (on file with author). Prior to the parties' abandonment, I had certified the parties' motion and attached a statement that explained why I believed the parties' motion lacked merit. Order Certifying Respondents' Motion to Recuse the Commission and Accompanying Statement by J. Thomas Rosch (May 29, 2008), *available at* <http://ftc.gov/os/adjpro/d9326/080529ordercert.pdf>.

<sup>42</sup> Order Rescinding Stay of Administrative Proceeding, Setting Scheduling Conference, and Designating Presiding Official, FTC Docket No. 9324 (August 8, 2008), *available at* <http://www.ftc.gov/os/adjpro/d9324/080808wholefoodsorder.pdf>

<sup>43</sup> Prior to filing in federal court, Whole Foods moved to disqualify any member of the Commission from serving as an ALJ on the grounds that the Commission's statements made in conjunction with the preliminary injunction proceedings showed that the Commission had prejudged the matter. Respondents' Motion to Recuse Commissioner J. Thomas Rosch as Administrative Law Judge ("Respondents' Motion to Recuse") (Aug. 22, 2008) *available at* <http://www.ftc.gov/os/adjpro/d9324/080822respmoqualifycomm.pdf>. The Commission rejected Whole Foods' argument. Order Denying Respondents' Motion to



trial schedule (which, it claimed, “rushed” Whole Foods to trial in five months) violated its due process rights.<sup>44</sup> Whole Foods eventually dismissed its due process claim when it became clear that it was going to settle the case.

In contrast to the constitutional due process claims, there has been a more active debate in the federal courts about whether the FTC’s structure (and the administrative state more generally) violates the U.S. Constitution’s separation of powers. The Constitution’s framers divided power – legislative, executive, and judicial – in three branches of government. While that seems like a straightforward division of power, the Constitution’s checks and balances framework – and Congress’s attempt to mimic that framework by creating a web of additional inter-branch checks and balances each time it creates a new “independent” governmental entity – raise a host of questions. Foremost among those is whether when Congress establishes an independent agency or commission in one branch with power that belongs to another, does it unconstitutionally vest legislative, executive, or judicial power in that entity?

In one of its earliest decisions on this issue,<sup>45</sup> its 1935 decision in *Humphrey’s Executor*, the Supreme Court considered whether Congress could constitutionally limit the President’s power to remove Commissioners under the Federal Trade Commission

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Disqualify the Commission (Sept. 5, 2008), *available at* <http://www.ftc.gov/os/adjpro/d9324/080905order.pdf>. Tellingly, Whole Foods did not move to disqualify the entire Commission from hearing an appeal on these same grounds – a fact that, in the Commission’s view, severely undercut the merits of its “prejudgment” claim. Notwithstanding the Commission’s finding, the Commission subsequently named a new ALJ to oversee the trial proceedings after the scheduling order was in place. Order Designating Administrative Law Judge (Oct. 20, 2008), *available at* <http://www.ftc.gov/os/adjpro/d9324/081020order.pdf>.

<sup>44</sup> Complaint for Declaratory and Injunctive Relief, *Whole Foods Mkt., Inc. v. FTC*, No. 1:08-cv-02121 (D.D.C. filed Dec. 8, 2008) (dismissed).

<sup>45</sup> See also *United States v. Perkins*, 116 U.S. 483 (1886); *Myers v. United States*, 272 U.S. 52 (1926).

Act.<sup>46</sup> President Hoover nominated William Humphrey to succeed himself as a member of the Commission and he was confirmed by the Senate for a term that was to expire on September 25, 1938.<sup>47</sup> In 1933, however, President Franklin Roosevelt wrote Humphrey and asked him to resign because “the aims and purposes of the Administration with respect to the work of the Commission can be carried out most effectively with personnel of my own selection.”<sup>48</sup> Commissioner Humphrey refused to resign so President Roosevelt terminated Humphrey’s term – a fact that Commissioner Humphrey ignored by continuing to serve out his term.<sup>49</sup> Humphrey died while in office and his estate sued the United States to recover his salary from the time of his termination until his death.

In a decision that is generally considered to provide the constitutional foundation for the administrative state,<sup>50</sup> the Court held that Congress did not violate the separation of powers when it established the Federal Trade Commission and limited the president’s removal power except for good cause. In so holding, the Court distinguished between

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<sup>46</sup> *Humphrey’s Ex’r v. United States*, 295 U.S. 602 (1935).

<sup>47</sup> *Id.* at 618.

<sup>48</sup> *Id.*

<sup>49</sup> *Id.* at 619.

<sup>50</sup> Some have also speculated that the decision was the Supreme Court’s response to an overly-activist President. See *Morrison v. Olson*, 487 U.S. 654, 724 (1988) (Scalia, J., dissenting) (noting that *Humphrey’s Executor* “was considered by many at the time the product of an activist, anti-New Deal Court bent on reducing the power of President Franklin Roosevelt”). Indeed, Justice Jackson, who had been Roosevelt’s Attorney General, later remarked:

I really think the decision that made Roosevelt madder at the Court than any other decision was that damn little case of *Humphrey’s Executor v. United States*. The President thought they went out of their way to spite him personally and they were giving him a different kind of deal than they were giving Taft.

*Synar v. United States*, 626 F. Supp. 1374, 1398 n.27 (D.D.C. 1986) (per curiam) (quoting E. Gerhart, *America’s Advocate: Robert H. Jackson* 99 (1958)).



administrative officials who performed “purely executive” functions (such as postmasters) and those officials who performed “quasi-legislative” and “quasi-judicial” functions (such as Federal Trade Commissioners). The Court held that, as to the former, the President had absolute removal power, but that, as to the latter, Congress could constitutionally limit the President’s power. In *Humphrey’s Executor’s* wake, the Supreme Court repeatedly has held that the administrative framework does not violate the Constitution so long as the President nominates and the Senate confirms the principal officers, with the caveat that Congress may constitutionally limit the President to a good-cause removal power.<sup>51</sup>

The tide may be turning, however. This past term, for the first time in 20 years, the Supreme Court revisited this separation of powers issue in an appeal that challenged the legality of the Public Company Accounting Oversight Board (“PCAOB”).<sup>52</sup> Under the Sarbanes-Oxley Act, SEC Commissioners appointed the PCAOB’s members who

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<sup>51</sup> Indeed, to date, the only cases in which the Supreme Court has held the structure of an administrative agency unconstitutional involved attempts by Congress to insert itself directly into the appointment process or to directly control an agency’s decisions through a veto-like power. Richard H. Pildes, *Separation of Powers, Independent Agencies, and Financial Regulation: The Case of the Sarbanes-Oxley Act*, 33 N.Y.U. J. L. & ECON. 5, 485 (2009), abstract available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1514585#](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1514585#) (citing *Metro. Wash. Airports Auth. v. Citizens for Abatement of Aircraft Noise, Inc.*, 501 U.S. 252 (1991) (direct congressional participation in agency decision-making); *Bowsher v. Synar*, 478 U.S. 714 (1986) (direct congressional involvement in removal process); *INS v. Chadha*, 462 U.S. 919 (1983) (direct congressional veto over agency decisions); *Buckley v. Valeo*, 424 U.S. 1, 1 (1976) (direct congressional participation in appointment process); *Myers v. United States*, 272 U.S. 52 (1926) (direct Senate participation in removal)).

<sup>52</sup> *Free Enter. Fund v. Pub. Co. Accounting Oversight Bd.*, No. 08-861, 2010 U.S. LEXIS 5524 (June 28, 2010) (5-4 decision) (Breyer, S., dissenting). Congress created PCAOB in the Sarbanes-Oxley Act of 2002, following several major financial and accounting scandals. The PCAOB registers public accounting firms, establishes auditing and ethics standards, conducts inspections and investigations of registered firms, and imposes sanctions as needed.

were then only removable by those Commissioners for good cause. At issue in the appeal was whether Congress impermissibly intruded on the Executive Branch's authority under Article II in violation of the Constitution's separation of powers principle by empowering decision-makers at this "agency within an agency" to engage in executive power who are twice-removed from the President. In a 2-1 decision, with Judge Kavanaugh writing a lengthy dissent (in which he characterized the case as "*Humphrey's Executor squared*"), the D.C. Circuit upheld the PCAOB's constitutionality.<sup>53</sup>

The Supreme Court, however, disagreed. In a 5-4 decision, with Chief Justice Roberts writing for the majority, the Court rejected the D.C. Circuit's separation of powers analysis and held that the PCAOB's removal provisions were unconstitutional. The Court reasoned that the "added layer of tenure protection" (in the form of the Commission) between the President and the Board and the fact that the Commission could only remove the Board members for "good cause" effectively insulated the Board from the President's supervision, making it virtually impossible for the President to control it. Finding that the President was not the ultimate judge of the Board's conduct, but was instead only the judge of the SEC Commissioners' conduct (who themselves could only be removed for good cause) the Court ruled the Board unconstitutional.<sup>54</sup>

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<sup>53</sup> *Free Enter. Fund v. Pub. Co. Accounting Oversight Bd.*, 537 F.3d 667 (D.C. Cir. 2008). The D.C. Circuit subsequently voted 5-4 to deny en banc review.

<sup>54</sup> In an opinion joined by Justices Stevens, Ginsburg, and Sotomayor, Justice Breyer dissented. The dissent rejected the majority's assumption that removal authority was the key way in which the President maintained authority and control over "inferior officers" in independent agencies, observing

[I]t appears that no President has ever actually sought to exercise that power by testing the scope of a "for cause" provision. See Bruff, *Bringing the Independent Agencies in from the Cold*, 62 VANDERBILT L. REV. EN BANC 63, 68 (2009), online at <http://vanderbiltlawreview>.



What does this suggest for the future? It's too soon to say. At the Supreme Court level, it may be the case that administrative agencies will come under greater scrutiny. Justice Scalia has long criticized the Court's separation of powers decisions on the grounds that *Humphrey's Executor* authorized the creation of a "headless fourth branch" of government by recognizing "independent" agencies that are, in his words, "*within* the Executive Branch (and thus authorized to exercise executive powers) independent of the control of the President."<sup>55</sup> Until the PCAOB decision, Justice Scalia had remained in the minority when it came to separation-of-powers issues. Whether a majority of the Court is really interested in revisiting administrative state's constitutional underpinnings or whether the PCAOB case was an outlier remains to be seen.

At a more practical level, however, I think it is safe to say that – whatever our critics may say – the FTC retains several layers of supervision by all three branches. We

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org/articles/2009/11/Bruff-62-Vand-L-Rev-En-Banc-63.pdf (noting that "Presidents do not test the limits of their power by removing commissioners . . ."); Lessig & Sunstein 110-112 (noting that courts have not had occasion to define what constitutes "cause" because Presidents rarely test removal provisions).

*Free Enter. Fund*, No. 08-861, 2010 U.S. LEXIS 5524 at 743.

<sup>55</sup> *Mistretta v. United States*, 488 U.S. 361, 424 (1989) (8-1 decision) (Scalia, J., dissenting); See *Synar v. United States*, 626 F. Supp. 1374, 1398 n.27 (D.D.C 1986) (per curiam) ("It has in any event always been difficult to reconcile *Humphrey's Executor's* 'headless fourth branch' with a constitutional text and tradition establishing three branches of government . . ."). As I read Justice Scalia's opinions, his principal critique is that the Constitution divides power among the three branches and any entity that exercises executive, legislative, or judicial power must be fully accountable to the head or heads of the relevant branch. Simply put, assuming the FTC and the independent counsel serve (at least part, if not entirely) Executive Branch functions, if the President has to wait for an FTC Commissioner or independent counsel to act so egregiously so as to warrant removal for "good cause," the President is not really in charge of the Executive Branch functions; Congress (by implementing the good cause standard) or, worse, the politically unaccountable independent agency or counsel, is in charge. That reassignment or sharing of power, in Justice Scalia's view, is contrary to the separation-of-powers framework.

are called to the Hill regularly to testify before our oversight Committee, as well as other Committees if they so require. Congress also, of course, controls our initial appropriation and, if it so chooses, can augment or strip us of our statutory authority at any moment. The Executive Branch not only nominates the Commissioners, but also (through OMB) gets the final say over the FTC's budget. Finally, not only is the agency subject to constitutional limitations, but also any decision that the Commission renders when it sits as an adjudicative body can be appealed by the respondent to any federal appellate court of its choice;<sup>56</sup> if the right to engage in unfettered forum shopping does not provide oversight by the judicial branch, I don't know what does. For all of these reasons, I think the FTC's structure is not only constitutionally sound, but optimal – it certainly is an improvement over the structure that houses our friends down the street at the Antitrust Division.

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<sup>56</sup> 15 U.S.C. § 45(c).





**Federal Trade Commission**  
**Protecting America's Consumers**



For Release: 06/17/2010

## **Federal Trade Commission Complaint Charges Conspiracy to Thwart Competition in Teeth-Whitening Services**

### **North Carolina Dental Board Charged with Improperly Excluding Non-Dentists**

The Federal Trade Commission today initiated an action against the state dental board in North Carolina, alleging that it is harming competition by blocking non-dentists from providing teeth-whitening services in the state. The FTC charged that the North Carolina Board of Dental Examiners (the "Dental Board") has impermissibly ordered non-dentists to stop providing teeth-whitening services, which has made it harder to obtain these services and more expensive for North Carolina consumers.

According to the FTC's administrative complaint, teeth-whitening services are much less expensive when performed by non-dentists than when performed by dentists. A non-dentist typically charges between \$100 and \$150 per whitening session, while a dentist typically charges between \$300 and \$700, with some dental procedures costing as much as \$1,000.

Whitening services provided by non-dentists are often available at salons, retail stores and mall kiosks. Dentists in North Carolina offer whitening services in their offices, and also provide take-home kits.

The Dental Board is a state agency created to regulate the practice of dentistry in North Carolina. It consists of eight members, including six licensed dentists, who collectively control the operation of the Dental Board. Any person who wants to practice dentistry in the state must be licensed by the Dental Board. The Dental Board also may ask a state court to deem a particular conduct an unauthorized practice of dentistry and issue an injunction.

Instead of seeking court orders to block non-dentists from providing teeth-whitening services, which the Dental Board believes constitute unauthorized practice of dentistry under North Carolina law, the Dental Board has unilaterally ordered non-dentists to stop providing whitening services. The Dental Board's actions, according to the FTC, are improper and harm competition.

"Without active supervision by a disinterested state authority, a regulatory board whose members have a financial interest in the industry it is charged with regulating cannot exclude its competitors from the marketplace," said Richard Feinstein, Director of the FTC's Bureau of Competition. "The North Carolina Dental Board does not have authority to decide on its own to limit the whitening services available to North Carolina residents, and its actions have decreased competition and harmed consumers."

According to the FTC's complaint, the Dental Board sent 42 letters instructing teeth-whitening providers that they were practicing dentistry illegally and ordering them to stop. In at least six cases, the Dental Board threatened or discouraged non-dentists who were considering opening teeth-whitening businesses. The Dental Board also sent at least 11 letters to third parties – mall owners and property management companies – stating that teeth-whitening services offered in malls are illegal.

The FTC's complaint alleges that as a result of the Dental Board's actions, the availability of teeth-whitening service in North Carolina has been significantly diminished. The complaint charges that the Dental Board's conduct is an anticompetitive conspiracy among the dentist members of the Dental Board in violation of federal law. The FTC seeks to stop the Dental Board's illegal conduct so that North Carolina consumers can benefit from competition between dentists and non-dentists for teeth-whitening services.

The Commission vote approving the administrative complaint was 4-0-1, with Commissioner Julie Brill recused. It was issued today, and a public version will be available shortly on the FTC's website and as a link to this press release.

**NOTE:** The Commission issues or files a complaint when it has "reason to believe" that the law has been or is being violated, and it appears to the Commission that a proceeding is in the public interest. The complaint is not a finding or ruling that the named parties have violated the law.

The administrative complaint marks the beginning of a proceeding in which the allegations will be ruled upon after a formal hearing by an administrative law judge.

The FTC's Bureau of Competition works with the Bureau of Economics to investigate alleged anticompetitive business practices and, when appropriate, recommends that the Commission take law enforcement action. To inform the Bureau about

particular business practices, call 202-326-3300, send an e-mail to [antitrust@ftc.gov](mailto:antitrust@ftc.gov), or write to the Office of Policy and Coordination, Room 394, Bureau of Competition, Federal Trade Commission, 600 Pennsylvania Ave, N.W., Washington, DC 20580. To learn more about the Bureau of Competition, read "Competition Counts" at <http://www.ftc.gov/competitioncounts>.

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(FTC File No. 081-0137)  
(NC Dental.final)

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Related Items:

***In the Matter of The North Carolina Board of Dental Examiners***  
Docket No. 9343  
FTC File No. 081 0137

Last Modified: Thursday, June 17, 2010





**In the Matter of:**

**The North Carolina Board of Dental Examiners**

*July 14, 2010  
Pretrial Conference*

**Condensed Transcript with Word Index**



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FEDERAL TRADE COMMISSION  
I N D E X

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23 ALSO PRESENT:

24 Victoria Arthaud, Federal Trade Commission

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1 UNITED STATES OF AMERICA  
2 FEDERAL TRADE COMMISSION

3  
 4  
 5 In Re: )  
 6 THE NORTH CAROLINA BOARD ) Docket No. 9343  
 7 OF DENTAL EXAMINERS, )  
 8 Respondent. )  
 9 \_\_\_\_\_)

13 INITIAL PRETRIAL CONFERENCE  
 14 WEDNESDAY, JULY 14, 2010  
 15 PUBLIC SESSION

19 BEFORE THE HONORABLE D. MICHAEL CHAPPELL  
 20 Administrative Law Judge

25 Reported by: Susanne Bergling, RMR-CRR-CLR

1 P R O C E E D I N G S

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 3 JUDGE CHAPPELL: Let me call to order Docket  
 4 9343, In Re: North Carolina Board of Dental Examiners.  
 5 I'll start with the appearance of the parties,  
 6 Government first.

7 MR. LANNING: William Lanning --  
 8 JUDGE CHAPPELL: You need to stand up to address  
 9 the Court.

10 MR. LANNING: William Lanning, complaint  
 11 counsel.

12 JUDGE CHAPPELL: Who else is at the table with  
 13 you?

14 MR. LANNING: At the table with me is Melissa  
 15 Westman-Cherry. She is my co-counsel in this matter,  
 16 complaint counsel as well. We have Ms. Isabel  
 17 Chiaradia, who is a paralegal who is going to assist  
 18 with the PowerPoint presentation, and Ms. Langley,  
 19 Stephanie Langley, who is our technical person.

20 JUDGE CHAPPELL: Thank you.  
 21 And for respondent?

22 MR. ALLEN: Thank you, Your Honor. Noel Allen,  
 23 of the law firm of Allen & Pinnix, representing the  
 24 North Carolina State Board of Dental Examiners.

25 JUDGE CHAPPELL: Is your client here?



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1 JUDGE CHAPPELL: So, they don't have to come to  
 2 Raleigh to answer?  
 3 MR. ALLEN: Correct. Correct.  
 4 Now, beyond that, in terms of I guess what I  
 5 would call just examples of statutory supervision -- and  
 6 this, again, gets to the heart of the fundamental  
 7 misunderstanding that this is a state agency. This is  
 8 the State. It is not a separate entity unto itself.  
 9 JUDGE CHAPPELL: Let's talk about active  
 10 supervision. Is it your position that the Goldfarb test  
 11 requires the statute to expressly require supervision,  
 12 or is it a factual inquiry, you need to come in and  
 13 prove -- can you come in and demonstrate that the  
 14 supervision is adequate or active?  
 15 MR. ALLEN: I don't think we need to reach the  
 16 evidentiary aspect of this, because, again, it's  
 17 statutory, and it is a state agency unto itself. It's  
 18 not a Goldfarb situation where there is some deferral to  
 19 a mixed bar that is both -- as Virginia was, a unified  
 20 bar, which is the association and the state bar rolled  
 21 together. It is a true state agency in and of itself.  
 22 And let me offer some examples of that statutory  
 23 supervision that ensure the degree of supervision that  
 24 the State, in general, has.  
 25 Aside from it being established by statute, the

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1 officers or the members of the Board, be they dentists  
 2 or otherwise, the officers of the State --  
 3 JUDGE CHAPPELL: Let me back up a second. Your  
 4 position would be the Goldfarb test isn't necessary  
 5 because your client is a state agency.  
 6 MR. ALLEN: Yes, sir.  
 7 JUDGE CHAPPELL: That there's no doubt there.  
 8 MR. ALLEN: It is, pure and simple, and the  
 9 statute says it is a state agency. And just to --  
 10 JUDGE CHAPPELL: And I think complaint counsel  
 11 might want to reply to that when you're finished.  
 12 MR. ALLEN: Certainly. Be glad to do that.  
 13 JUDGE CHAPPELL: I've reserved five minutes for  
 14 her to respond if she'd like.  
 15 MR. ALLEN: I'd love to hear it, Your Honor.  
 16 But it's very clear in the statutes that this is  
 17 a total creation of the statute, and just by way of  
 18 example, aside from the oath of office that's required,  
 19 the Ethics Act applies to each member of the Board as  
 20 well as the agency itself. If someone has a conflict of  
 21 interest, such as trying to eliminate competition, then  
 22 they would have a conflict of interest and be removed  
 23 from office by virtue of a violation of that Ethics Act.  
 24 There are several other components of the Ethics Act,  
 25 certainly, as well.

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1 Aside from that, this particular state agency  
 2 is -- its funds are state funds. They are designated as  
 3 state funds. They are collected in the name of the  
 4 State. The Board must undergo an annual audit, must be  
 5 submitted not only to the state auditor but to the  
 6 Governor as well. There is a statutorily specified per  
 7 diem that is regulated by the State. All the rules that  
 8 are adopted by the Board must go through the Rules  
 9 Review Commission, which is another agency of the State,  
 10 who shepherds and reviews all rules for statutory  
 11 authority.  
 12 JUDGE CHAPPELL: You see that the complaint  
 13 actually states that there is no state action defense.  
 14 You saw that, right?  
 15 MR. ALLEN: Yes, Your Honor. I did.  
 16 JUDGE CHAPPELL: Do you really think that the  
 17 people who voted out the complaint didn't consider the  
 18 law before they made that decision? Do you think that  
 19 they forgot something?  
 20 MR. ALLEN: They are fundamentally wrong on  
 21 this, absolutely. They do not understand this Board and  
 22 the way that North Carolina structured it.  
 23 Other examples, all these rules have to be  
 24 approved by the --  
 25 JUDGE CHAPPELL: But see, you're talking about

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1 how the Board is structured. You're getting into facts.  
 2 MR. ALLEN: These are statutes. These are,  
 3 again, statutory means by which the State, as a  
 4 nongeneric state, maintains control over this agency of  
 5 the State. Not only do all rules have to be approved,  
 6 administrative actions must be pursued pursuant to the  
 7 Administrative Procedures Act. This Board must comply  
 8 with the open meetings law and must comply with the  
 9 Public Records Act, all, again, statutory as well.  
 10 An aggrieved party, say, for example, a teeth  
 11 whitening kiosk that disagrees with the interpretation,  
 12 could request a declaratory ruling. There are  
 13 provisions for making the request, and if they were to  
 14 make that request, then the Board would either have to  
 15 rule within 60 days or decline to rule. If they ruled  
 16 and the aggrieved person doesn't like it, they could  
 17 take that to Superior Court. If they refused to rule,  
 18 they could go to Superior Court, treating the refusal to  
 19 rule as a negative ruling. And so it goes into court  
 20 even as to interpretations of the Board, and that is  
 21 true for any state agency in North Carolina.  
 22 The Board, again, must go to court for civil  
 23 injunctive relief, must go to the court and the DA for  
 24 the prosecution for criminal actions as well. There are  
 25 several provisions within Chapter 93B of the North

UNITED STATES OF AMERICA  
BEFORE THE FEDERAL TRADE COMMISSION



**COMMISSIONERS:**     **Jon Leibowitz, Chairman**  
                              **William E. Kovacic**  
                              **Edith Ramirez**  
                              **J. Thomas Rosch**  
                              **Julie Brill (recused)**

\_\_\_\_\_ )  
In the Matter of )  
                          ) )  
THE NORTH CAROLINA [STATE] BOARD ) DOCKET NO. 9343  
OF DENTAL EXAMINERS. ) )  
  ) )  
\_\_\_\_\_ )

**CERTIFICATION**

I state under penalty of perjury that the exhibits to Respondent’s Motion to Disqualify the Commission were prepared and assembled under my supervision, and that the exhibits, to the best of my knowledge and belief, are true and correct copies of the originals.

The documents identified in Section IV of Respondent’s Motion are currently in the Commission’s possession and are true and accurate documents.

/s/ Alfred P. Carlton, Jr.

\_\_\_\_\_  
Alfred P. Carlton, Jr.  
Respondent’s Counsel  
919-755-0505