



## MEMORANDUM

From: AMC Staff<sup>†</sup>  
To: All Commissioners  
Date: June 5, 2006  
Re: State Action Doctrine Discussion Memorandum

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The Commission agreed to study whether courts should change or clarify their application of the state action doctrine, under which activity undertaken pursuant to state law is immune from challenge under federal antitrust law. It received suggestions to study this issue from, among others, the Senate Judiciary Subcommittee on Antitrust, Competition Policy, and Consumer Rights,<sup>1</sup> then-Assistant Attorney General R. Hewitt Pate,<sup>2</sup> and the Section of Antitrust Law of the American Bar Association.<sup>3</sup>

The Commission requested comment on the following issues related to the state action doctrine:

1. Should courts change or clarify the application of the state action doctrine?

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<sup>†</sup> This memorandum is a brief summary prepared by staff of the comments and testimony received by the AMC to assist Commissioners in preparing for deliberations. All Commissioners have been provided with copies of comments and hearing transcripts, which provide the full and complete positions and statements of witnesses and commenters.

<sup>1</sup> Letter from Senator Mike DeWine & Senator Herb Kohl, to Deborah A. Garza, Chair, Antitrust Modernization Commission, at 3 (Oct. 1, 2004).

<sup>2</sup> Letter from R. Hewitt Pate, Assistant Attorney General, Department of Justice, Antitrust Division, to Deborah A. Garza, Chair, Antitrust Modernization Commission, at 3 (Jan. 5, 2005).

<sup>3</sup> Report of the Section of Antitrust Law of the American Bar Association to the Antitrust Modernization Commission, at 13 (Sept. 30, 2004).

- a. Do courts currently interpret the “clear articulation” prong of the state action doctrine so as to immunize conduct only in circumstances in which the state intended to displace competition? Do courts unduly rely on “foreseeability” analysis in applying the “clear articulation” prong?
  - b. Should courts rely on the elements proposed by the FTC Staff’s State Action Task Force (state authorization of conduct at issue and deliberate adoption of a policy to displace competition in the manner at issue) to determine whether the “clear articulation” prong is satisfied? *See Federal Trade Commission Staff, Report of the State Action Task Force* 51 (Sept. 2003) (“FTC Report”).
  - c. Should there be other changes to interpretation and application of the “clear articulation” prong?
2. Should courts change or clarify application of the active supervision prong?
    - a. Do courts currently interpret the “active supervision” prong of the state action doctrine so as to subject immunized activity to meaningful state oversight?
    - b. Should courts rely on the elements proposed by the FTC Staff’s State Action Task Force (development of adequate factual record, written decision, and specific assessment) to determine whether the “active supervision” prong is satisfied? Are these elements workable in practice? *See* FTC Report at 55.
    - c. Should courts make any other changes when interpreting and applying the “active supervision” prong?
  3. Should courts require different degrees of “clear articulation” by legislators and different levels of “active supervision” by executive or regulatory entities depending upon the circumstances (a “tiered approach”)?
  4. Do courts in applying the state action doctrine currently account for spillover effects (anticompetitive conduct immunized by one state that has a deleterious effect on consumers in other states)? If not, should courts address spillover effects under the state action doctrine? What standards should govern that analysis?
  5. How should courts apply the state action doctrine to various governmental entities?
    - a. Should state agencies and departments be subject to the “active supervision” prong of the state action doctrine? If so, who should actively supervise these state entities?
    - b. When should courts treat “quasi-governmental” entities as a private actor (subject to the “active supervision” prong) or as a municipality (potentially not subject to the “active supervision” prong)?
    - c. Should courts apply the “active supervision” prong to a municipality or state entity when it acts as a “market participant”? If so, how should that

entity's activities as a regulator be distinguished from its activities as a "market participant"?

- d. Should Congress repeal the Local Government Antitrust Act of 1984?<sup>4</sup>

The Commission held a hearing on September 29, 2005, on the state action doctrine. The panel included Maureen K. Ohlhausen, Director of the Office of Policy Planning, Federal Trade Commission ("FTC"); John C. Christie, Jr., senior counsel at Wilmer Cutler Pickering Hale and Dorr; Robert M. Langer, partner at Wiggin and Dana; and Carlton A. Varner, partner at Sheppard Mullin Richter & Hampton. The Commission also received comments from several interested institutions and individuals.<sup>5</sup>

## I. Background

Under the "state action" doctrine, activity undertaken pursuant to a state regulatory regime or other state law is immune from challenge under federal antitrust law.<sup>6</sup> State action immunity is a judicial doctrine developed to resolve tension between principles of federalism and state sovereignty, on the one hand, and national policies favoring competition, on the other.<sup>7</sup>

The state action doctrine originated in *Parker v. Brown*.<sup>8</sup> In *Parker*, the Supreme Court upheld the legality of a California program regulating the marketing of raisins, as an "act of

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<sup>4</sup> 70 Fed. Reg. 28,902, 28,905-06 (May 19, 2005).

<sup>5</sup> See Comments of The American Antitrust Institute, Working Group on Immunities and Exemptions (July 15, 2005) ("AAI Comments"); American Insurance Association, Re: Request for Public Comment (July 15, 2005); Perennial Ryegrass Bargaining Association's Response to the Antitrust Modernization Commission's Request for Public Comments (July 15, 2005) ("PRBA Comments"); Property Casualty Insurers Association of America, Re: State Action and *Noerr-Pennington* Doctrines (July 15, 2005).

<sup>6</sup> See ABA Section of Antitrust Law, *Antitrust Law Developments*, at 1213 (5th ed. 2002) ("*Antitrust Law Developments*").

<sup>7</sup> See Carlton A. Varner, State Action Immunity Statement, at 2, 5 (Sept. 29, 2005) ("Varner Statement"); Federal Trade Commission Staff, *Report of the State Action Task Force 5* (Sept. 2003) ("*FTC State Action Report*").

<sup>8</sup> 317 U.S. 341 (1943).

government which the Sherman Act did not undertake to prohibit.”<sup>9</sup> The Court explained that principles of federalism immunized such state action from antitrust attack: “In a dual system of government in which, under the Constitution, the states are sovereign . . . an unexpressed purpose to nullify a state’s control over its officers and agents is not lightly to be attributed to Congress.”<sup>10</sup> In light of state sovereignty and principles of federalism, Congress could not be presumed to have intruded on state prerogatives through the Sherman Act.<sup>11</sup> “[N]othing in the language of the Sherman Act or in its history . . . suggests that its purpose was to restrain a state or its officers or agency from activities directed by its legislature.”<sup>12</sup> Thus, for national antitrust policies to supercede federalism concerns, Congress must expressly say so in the statute.<sup>13</sup>

The state action doctrine applies not only to state governmental actors themselves, but also, in certain circumstances, to *quasi*-governmental entities and private actors. The actions of state governmental actors—specifically a legislature or state court—are generally immune from antitrust liability without further inquiry.<sup>14</sup> This is because “when the conduct is that of the sovereign itself . . . the danger of unauthorized restraint of trade does not arise.”<sup>15</sup> What constitutes the “state,” however, has given rise to extensive litigation. For example, cities and

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<sup>9</sup> See *id.* at 352; see also *id.* at 350-51 (states are sovereign save only as Congress may constitutionally subtract from their authority); *Town of Hallie v. City of Eau Claire*, 471 U.S. 34, 38 (1985); *Cantor v. Detroit Edison Co.*, 428 U.S. 579, 632 (1976); *FTC v. Ticor Title Ins. Co.*, 504 U.S. 621, 633 (1992) (“Our decision [in *Parker*] was grounded in principles of federalism.”).

<sup>10</sup> *Parker*, 317 U.S. at 350-51.

<sup>11</sup> See *FTC State Action Report*, at 5.

<sup>12</sup> *Parker*, 317 U.S. at 350-51.

<sup>13</sup> See *FTC State Action Report*, at 5.

<sup>14</sup> See *Parker*, 317 U.S. at 350-52; *Bates v. State Bar of Ariz.*, 433 U.S. 350 (1977); *FTC State Action Report*, at 6.

<sup>15</sup> *Hoover v. Ronwin*, 466 U.S. 558, 569 (1984).

other municipalities, public service commissions, and state regulatory boards are not the “state” for purposes of the state action doctrine.<sup>16</sup>

The actions of private economic actors, as well as of governmental or *quasi*-governmental entities not considered to be the “state,” are immune from antitrust liability only if they pass the two-part test set forth in *California Retail Liquor Dealers Ass’n v. Midcal Aluminum, Inc.*: (1) the challenged restraint must be “one clearly articulated and affirmatively expressed as state policy,” and (2) “the policy must be ‘actively supervised’ by the state itself.”<sup>17</sup> The first requirement, that of clear articulation, serves to ensure that the state has affirmatively authorized departures from free market competition.<sup>18</sup> The second requirement, that of active supervision, is intended to ensure that state action immunity “will shelter only the particular anticompetitive acts of private parties that, in judgment of the State, actually further state regulatory policies.”<sup>19</sup> The precise contours of these two prongs are described more fully in connection with the proposed modifications, below.

The Supreme Court’s most recent ruling on the state action doctrine was in *FTC v. Ticor Title Insurance Company*.<sup>20</sup> In that case, the Court reconfirmed the *Midcal* test and reiterated the doctrine’s basis in state sovereignty and federalism.<sup>21</sup> The Court also reiterated that the purpose of the active supervision inquiry is “not to determine whether the State has met some normative

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<sup>16</sup> See *Southern Motor Carriers Rate Conference, Inc. v. United States*, 471 U.S. 48 (1985) (decisions by state executive departments, agencies, or special authorities do not automatically qualify as state action); *City of Lafayette v. Louisiana Power & Light Co.*, 435 U.S. 389, 412 (1978) (“[c]ities are not themselves sovereign”); *FTC State Action Report*, at 7.

<sup>17</sup> 445 U.S. 97, 105 (1980).

<sup>18</sup> See *Antitrust Law Developments*, at 1214; Varner Statement, at 18; *FTC State Action Report*, at 8, 52.

<sup>19</sup> *Patrick v. Burget*, 486 U.S. 94, 100-01 (1988).

<sup>20</sup> 504 U.S. 621 (1992).

<sup>21</sup> See *id.* at 632-33, 636.

standard, such as efficiency, in its regulatory practices,” but rather “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>22</sup>

The FTC has devoted significant attention to the state action doctrine in recent years. First, as described more fully below, FTC Staff issued a report on the state action doctrine. That report recommended “clarification and re-affirmation of the original purposes of the state action doctrine to help ensure that robust competition continues to protect consumers.”<sup>23</sup> Second, the FTC addressed the state action doctrine in Part III litigation against the South Carolina State Board of Dentistry (“the Board”).<sup>24</sup> That matter addressed the question of whether the Board, which is a regulatory entity created pursuant to state law, violated federal antitrust law by enacting a regulation that appeared to be inconsistent with legislation designed to improve access to dental care for children of low-income families.<sup>25</sup> The FTC concluded that the state action doctrine did not protect the Board’s actions because those actions “appear to directly conflict with a specific legislative mandate,”<sup>26</sup> and thus were not pursuant to a “clearly articulated” state policy to displace competition.<sup>27</sup>

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<sup>22</sup> *Ticor*, 504 U.S. at 634-35.

<sup>23</sup> *FTC State Action Report*, at 1.

<sup>24</sup> See Opinion and Order of the Commission, *In the Matter of South Carolina State Board of Dentistry* (July 30, 2004) (No. 9311), available at <http://www.ftc.gov/os/adjpro/d9311/040728commissionopinion.pdf> (interlocutory appeal to Fourth Circuit rejected).

<sup>25</sup> See *id.* at 1.

<sup>26</sup> See *id.* at 2.

<sup>27</sup> See *id.* at 19-29 (holding that “while clear articulation does not require a state entity to show ‘express authorization’ for every specific anticompetitive act . . . it does anticipate that the anticompetitive action will have a significant nexus to, or degree of ‘foreseeability’ stemming from, an identifiable state policy”). The Commission also found that the Board was not *ipso*

## II. Discussion of Issues

The state action doctrine has been criticized on a number of grounds. In general, witnesses and commenters before the Commission acknowledged that current doctrine promotes state sovereignty and values of federalism.<sup>28</sup> But the doctrine has been criticized for (1) allowing anticompetitive conduct in an overbroad manner;<sup>29</sup> and (2) being insufficiently sensitive to the issue of interstate spillover effects.<sup>30</sup>

Commenters and witnesses focused their criticisms on several aspects of the state action doctrine: (a) the clear articulation prong; (b) the active supervision prong; (c) its application when the government is a “market participant;” and (d) anticompetitive spillover effects across state borders. Several commenters addressed whether statutory change is appropriate.

### A. The “clear articulation” prong of the state action doctrine

The state action doctrine requires that, in order for immunity to attach, the challenged conduct must be undertaken “pursuant to a ‘clearly articulated and affirmatively expressed state policy’ to replace competition with regulation.”<sup>31</sup> Current law provides that the state need not explicitly authorize specific conduct to satisfy this prong, as long as the state legislature’s intent

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*facto* the state, and was subject to the more rigorous analysis. *See id.* at 16-19. Two recent cases have also addressed the state action doctrine. *See Brentwood Academy v. Tennessee Secondary School Athletic Association*, 442 F.3d 410, 442 (6th Cir. 2006) (holding that athletic association was not entitled to state action immunity for its conduct governing recruiting of student athletes, because there was no clearly articulated state policy); *Jackson, Tennessee Hospital Co. v. West Tennessee Healthcare, Inc.*, 414 F.3d 608 (6th Cir. 2005) (holding requisite authority to invoke state action doctrine existed).

<sup>28</sup> *See, e.g.*, Varner Statement, at 5.

<sup>29</sup> *See, e.g.*, Prepared Statement of Robert M. Langer, Before The Antitrust Modernization Commission, Hearing Panel On Immunities And Exemptions: The State Action Doctrine, at 2 (Sept. 29, 2005) (“Langer Statement”).

<sup>30</sup> *See, e.g.*, Varner Statement, at 19-20.

<sup>31</sup> *Hoover*, 466 U.S. at 569.

to establish a regulatory program displacing competition is “clear.”<sup>32</sup> The clear articulation standard was developed as a mechanism to harmonize state and national policies—the national policy remains except when supplanted by a “deliberate and intended state policy.”<sup>33</sup>

Some observers have criticized current application of the clear articulation requirement.

- Some courts have “conflated a general authorization of conduct with a specific intention to displace competition.”<sup>34</sup> Such an approach results in immunizing conduct that should not properly be immunized.<sup>35</sup>
- Some courts have been too quick to jump from finding a general regulatory scheme to concluding that such a scheme shelters all forms of anticompetitive conduct under it.<sup>36</sup> Such an approach does not answer the question of whether the state intended to displace competition in the specific manner at issue.<sup>37</sup>
- To the extent that courts will consider an *ex post* expression of state legislative intent, anticompetitive conduct that is undertaken without any express authority can retroactively be immunized.<sup>38</sup> This blurs the distinction between immune and non-immune actions, and makes it difficult for actors to have appropriate expectations about the lawfulness of their behavior.

Commenters and witnesses advocated various possible reforms to the clear articulation prong. First, the FTC Report proposed a series of reforms. Second, some witnesses proposed adoption of a test analogous to “sovereign compulsion” required to immunize conduct undertaken pursuant to foreign authority. Finally, one witness proposed using the “regulated by state law” requirement of the McCarran-Ferguson Act.

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<sup>32</sup> *Southern Motor Carriers*, 471 U.S. at 61; *see also Snake River Valley Elec. Ass’n v. PacifiCorp.*, 238 F.3d 1189, 1192 (9th Cir. 2001) (rejecting plaintiff’s argument that state action doctrine protects anticompetitive conduct only if compelled by state regulation).

<sup>33</sup> *See FTC State Action Report*, at 50; *Ticor*, 504 U.S. at 636; Varner Statement, at 2, 16-17.

<sup>34</sup> *See FTC State Action Report*, at 50; ABA Section of Antitrust Law Comments on the FTC Task Force Report on the State Action Doctrine at 12 (“ABA State Action Comments”).

<sup>35</sup> *See FTC State Action Report*, at 50.

<sup>36</sup> *See id.*

<sup>37</sup> *See id.*

<sup>38</sup> *See Antitrust Law Developments*, at 1215.

1. *FTC Report proposal*

The FTC Staff Report recommended reaffirming a formulation of the “clear articulation” standard that it believes is better tailored to the original purpose and goals of the state action doctrine.<sup>39</sup> According to the FTC Report, “an appropriate clear articulation standard . . . 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>40</sup> The state would not need to articulate an express policy displacing competition in the precise “manner at issue,” but the policy to displace competition should be based on the words of the statute, clear legislative history, and the nature of the authorized conduct.<sup>41</sup>

Under this standard:

- A “clearly articulated and affirmatively expressed state policy to displace competition” is required.<sup>42</sup>
- While the state need not have compelled the anticompetitive conduct at issue, neither a general grant of power nor “mere authorization” is sufficient to establish immunity.<sup>43</sup>
- The focus of inquiry should be on the substance of the state’s policy regarding competition, and the inquiry should be “pointed and deliberate.”<sup>44</sup> Courts should make careful inquiry and findings concerning the substance of the state’s policy regarding competition specifically.
- Legislative intent to displace competition is appropriately found where either the exercise of a specific power will result in general anticompetitive effects,<sup>45</sup> or the exercise of a general power will result in specific anticompetitive effects.<sup>46</sup>

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<sup>39</sup> See Trans. at 9 (Ohlhausen).

<sup>40</sup> See *FTC State Action Report*, at 51.

<sup>41</sup> See *id.*

<sup>42</sup> *Id.* at 9; see also Varner Statement, at 6, 16-17.

<sup>43</sup> See *FTC State Action Report*, at 9, 33.

<sup>44</sup> See *id.* at 33.

<sup>45</sup> See *id.* at 33-34; Varner Statement, at 6, 16-17. Some would require “authority to act legislation to be accompanied by a statement that the authority includes the right to restrict competition where justified by the public interest.” See Varner Statement, at 17; see also

- Foreseeability is a useful tool in inquiring about state policy to displace competition,<sup>47</sup> but is not an end in itself.<sup>48</sup> That anticompetitive effects are foreseeable does not complete the inquiry, although it may suggest a state policy to displace competition.

The FTC’s proposal essentially calls for reaffirming the current standard as originally articulated in *Parker*, reining in perceived expansions, or relaxations, by lower courts.<sup>49</sup> It aims to correct two “common pitfalls” that have appeared in lower court decisions.<sup>50</sup> First, the FTC Report concluded that lower courts have often conflated a general authorization of conduct with a specific intention to displace competition.<sup>51</sup> The FTC proposal maintains them as distinct inquiries.<sup>52</sup> Second, the FTC Report concluded that lower courts have sometimes been too quick to jump from finding a general regulatory scheme to concluding that such a scheme shelters all forms of anticompetitive conduct under it.<sup>53</sup> They do not engage in further inquiry as to whether the state intended to displace competition in the manner at issue.<sup>54</sup> The FTC proposal calls for restoring this inquiry.<sup>55</sup> The FTC proposal also would remind courts of the appropriate role of

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*Jackson Tennessee Hosp. v. West Tennessee Healthcare Inc.*, 414 F.3d 608, 611 (10th Cir. 2005) (statute provided that a hospital district may exercise its powers “regardless of the competitive consequences thereof”).

<sup>46</sup> See *FTC State Action Report*, at 33-34.

<sup>47</sup> See, e.g., *Doron Precision Sys., Inc. v. FAAC, Inc.*, 423 F. Supp. 2d 173, 188 (S.D.N.Y. Mar. 23, 2006) (“[i]n a sense, this inquiry is really about foreseeability”).

<sup>48</sup> See *FTC State Action Report*, at 11, 52 n.226; ABA State Action Comments, at 11.

<sup>49</sup> See *FTC State Action Report*, at 50.

<sup>50</sup> See *id.*

<sup>51</sup> See *id.*

<sup>52</sup> See *id.*

<sup>53</sup> See *id.*

<sup>54</sup> See *id.*

<sup>55</sup> See *id.*

foreseeability analysis—as a “tool for probing the state’s intentions and policies, not as an end in itself.”<sup>56</sup>

An overall benefit of the FTC’s proposal is to assign political responsibility.<sup>57</sup> The only comments specifically opposing the FTC Report’s proposal were made by those who prefer an even narrower “sovereign compulsion” test.<sup>58</sup>

## 2. *Sovereign compulsion test*

Two witnesses proposed that the state action doctrine, and in particular the clear articulation prong, could be replaced with a “sovereign compulsion” test.<sup>59</sup> This is drawn from the foreign sovereign compulsion test, which exempts a private party from liability for acts or omissions compelled by a foreign government.<sup>60</sup> Under such a standard, “clear articulation” would exist only where a state compelled the action giving rise to the antitrust claim. One witness characterized this standard as “get[ting] back to real clear articulation.”<sup>61</sup>

### Pros

- A compulsion test is relatively clearer because it would require that a state’s law explicitly compel the conduct at issue.<sup>62</sup>
- A compulsion test would recognize the origins of the doctrine, both in *Parker* and more recently in *Goldfarb v. Virginia State Bar*, which held that, for the immunity

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<sup>56</sup> *Id.* at 51.

<sup>57</sup> *See* Trans. at 63 (Ohlhausen).

<sup>58</sup> *See, e.g.,* Trans. at 83 (Varner).

<sup>59</sup> *See* Trans. at 83 (Varner); Trans. at 83-84 (Ohlhausen).

<sup>60</sup> *See Interamerican Refining Corp. v. Texaco Maracaibo, Inc.*, 307 F. Supp. 1291, 1298 (D. Del. 1970).

<sup>61</sup> *See* Trans. at 83 (Varner).

<sup>62</sup> Varner Statement, at 8; Trans. at 83 (Varner) (“[A] lot of the issues and the problems in the state action doctrine arise simply from the fact that there’s no—that we lack compulsion, and went off on a road which seems to meander in a lot of different directions.”); Trans. at 83-84 (Ohlhausen).

to apply, “anticompetitive activities must be *compelled* by direction of the State acting as a sovereign.”<sup>63</sup>

### Cons

- More groups might petition Congress for special-interest exemptions in order to ensure immunity from challenge under federal antitrust law.<sup>64</sup>
  - Such a standard could limit the ability of states to regulate commerce by requiring that legislation specifically compel discrete forms of conduct undertaken to achieve a goal.<sup>65</sup> Moreover, it may result in more, rather than less, anticompetitive conduct by precluding private parties from acting in a less anticompetitive manner.<sup>66</sup>
3. *Use “regulated by state law” requirement analogous to McCarran-Ferguson*

Some commenters suggest using the second part of the McCarran-Ferguson Act test—that the activity be “regulated by state law”—in place of the current clear articulation prong of the state action doctrine.<sup>67</sup> Judicial interpretations of the McCarran-Ferguson provision have described the requirements for *Parker* immunity as “significantly more stringent” than the requirements under the McCarran-Ferguson Act.<sup>68</sup> That test finds “regulation by state law” when there is legislation on the books that either prohibits or allows the challenged anticompetitive conduct.<sup>69</sup> The state regulation requirement is satisfied by the existence of a general administrative scheme of regulation affording regulators jurisdiction over the challenged practice, regardless of whether it is exercised.<sup>70</sup> The state law need not expressly authorize

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<sup>63</sup> *Goldfarb v. Virginia State Bar*, 421 U.S. 773, 791 (emphasis added) (1975) (“*Goldfarb*”); Varner Statement, at 8 (citing *Goldfarb*).

<sup>64</sup> See Trans. at 84 (Langer).

<sup>65</sup> See Trans. at 85-86 (Christie).

<sup>66</sup> See Trans. at 86 (Christie).

<sup>67</sup> See Trans. at 46 (Christie).

<sup>68</sup> See *Arroyo-Melecio v. Puerto Rican Am. Ins. Co.*, 398 F.3d 56, 71 (1st Cir. 2005).

<sup>69</sup> See Trans. at 42 (Christie).

<sup>70</sup> See *Antitrust Law Developments*, at 1373.

anticompetitive insurer agreements or the challenged practice.<sup>71</sup> The term “regulated by state law,” however, is subject to the same lack of clarity as any, and courts may differ in their interpretations of it.

B. The “active supervision” prong of the state action doctrine

The active supervision prong of the state action doctrine requires that the state both has *and* exercises independent power to review the challenged conduct, and exercises ultimate control.<sup>72</sup> The state must supervise both the general regulatory scheme and the particular conduct at issue.<sup>73</sup> As the Supreme Court stated in *Town of Hallie v. City of Eau Claire*, the active supervision prong serves an evidentiary function and aims to ensure that the actor is engaging in the challenged conduct pursuant to state policy.<sup>74</sup> It applies to private actors, because when they engage in anticompetitive behavior, there is “a real danger” that they are acting to further their own interests, rather than those of the state.<sup>75</sup> However, it does not apply to municipalities, because “there is little or no danger” that they are engaged in anticompetitive behavior for private benefit.<sup>76</sup> The only danger is that municipalities will seek to further parochial interests at the expense of state goals, but this danger is small because of the “clear articulation” prong of the doctrine.<sup>77</sup> Thus, the Court held that “[o]nce it is clear that state

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<sup>71</sup> *See id.*

<sup>72</sup> *See FTC State Action Report*, at 20; *Patrick*, 486 U.S. at 101; *Ticor*, 504 U.S. at 634-35.

<sup>73</sup> *See FTC State Action Report*, at 20-21.

<sup>74</sup> *Town of Hallie*, 471 U.S. at 46.

<sup>75</sup> *Id.* at 47.

<sup>76</sup> *Id.*

<sup>77</sup> *Id.*

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>78</sup>

### Benefits

- Ensures that state action immunity “will shelter only the particular anticompetitive acts of private parties that, in the judgment of the State, actually further state regulatory policies.”<sup>79</sup>
- Ensures that “particular anticompetitive mechanisms operate because of a deliberate and intended state policy.”<sup>80</sup>
- Requires a court 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>81</sup>
- Ensures that the private actor is engaging in the challenged conduct pursuant to state policy, and not in pursuit of his own private interests.<sup>82</sup>
- Assigns political responsibility for the state's actions.<sup>83</sup>
- Promotes the citizen-participation value of federalism.<sup>84</sup>

### Criticisms

- Even after *Ticor*, the level of state regulatory activity necessary to meet the “active supervision” standard is unclear. Although judicial decisions have addressed cases in which state regulators have been either particularly active,<sup>85</sup> or

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*Id.*

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*Patrick*, 486 U.S. at 100-01.

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*Ticor*, 504 U.S. at 636.

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*Id.* at 634.

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See *FTC State Action Report*, at 12; *Town of Hallie*, 471 U.S. at 46.

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See *FTC State Action Report*, at 14; *Ticor*, 504 U.S. at 636.

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See *FTC State Action Report*, at 15; 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) (“Inman & Rubinfeld, *Making Sense*”); Thomas M. Jorde, *Antitrust and the New State Action Doctrine: A Return to Deferential Economic Federalism*, 75 Cal. L. Rev. 227, 249 (1987) (“Jorde, *Return*”).

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See John C. Christie, Jr., *Active Supervision After Ticor: Be Careful of What You Wish For!*, at 6-7 (Sept. 29, 2005) (“Christie Statement”). Public utilities cases have had a high level of regulatory activity. See, e.g., *North Star Steel Co. v. MidAmerican Energy Holdings Co.*, 184 F.3d 732, 739 (8th Cir. 1999) (utilities board involved in active supervision of definition of

virtually inactive,<sup>86</sup> the resulting law remains unclear regarding the level of supervision necessary to obtain the immunity.

- Courts have reached differing conclusions regarding the relevance of how the regulatory authority arose—for example, whether it was prompted by the regulated parties. Currently courts look primarily at the quantum of supervision, but a qualitative component would make such determinations more finely tuned to the circumstances.<sup>87</sup>
- Private actors proceeding in reliance on the existence of the state action doctrine can never precisely know the exact dimensions of state intervention until after the state actors have acted.<sup>88</sup> As a result, private actors may shy away from accepting the state’s invitation to participate in state regulated activity, undermining the ability of the states to implement a sensible regulatory regime.<sup>89</sup>

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exclusive delivery territories); *Yeager’s Fuel, Inc. v. Pennsylvania Power & Light Co.*, 22 F.3d 1260 (3d Cir. 1994) (public utility commission actively supervised rate-setting and incentives that promote use of electric power); *DFW Metro Line Svcs. v. Southwestern Bell Telephone Corp.*, 988 F.2d 601 (5th Cir. 1993) (public utility commission actively supervised telephone rates and contracts).

<sup>86</sup> See Christie Statement, at 6-8; see also *In the Matter of Kentucky Household Goods Carriers Assoc., Inc.*, 2005 FTC LEXIS 124 (June 21, 2005). In *Kentucky Carriers*, the Commission found active supervision to be absent where one part time employee with other job responsibilities used his knowledge about the industry and the *Wall Street Journal* to assess the reasonableness of proposed rate increases.

<sup>87</sup> See Christie Statement, at 4-5; *Ticor*, 504 U.S. at 644 (Rehnquist, C.J., dissenting); Jeffrey M. Cross & Patrick J. Ahern, *FTC v. Ticor Title Insurance: Supreme Court Puts State Action Immunity Under the Lens*, 7 *Antitrust* 1, 24 (Fall/Winter 1992); *FTC State Action Report*, at 39; see also *Trans.* at 16-17 (Christie).

<sup>88</sup> See Christie Statement, at 4-5; see also *Ticor*, 504 U.S. at 647 (O’Connor, J., dissenting) (“The regulated entity has no control over the regulator, and very likely will have no idea as to the degree of scrutiny that its filings may receive. Thus, a party could engage in exactly the same conduct in two States, each of which had exactly the same policy of allowing anticompetitive behavior and exactly the same regulatory structure, and discover afterward that its actions in one State were immune from antitrust prosecution, but that its action in the other resulted in treble-damages liability.”); *Trans.* at 17 (Christie) (“this does seem to me to put private parties in very unfortunate jeopardy”).

<sup>89</sup> See Christie Statement, at 6.

1. *FTC Report proposal*

The FTC Report recommended clarifying and strengthening the standard for “active supervision” by requiring courts to consider three factors.<sup>90</sup> As proposed by FTC Staff, in determining whether active supervision is present, a court should:

- Consider whether the state “develop[ed] an adequate factual record, including notice and an opportunity to be heard.”<sup>91</sup>
- Consider whether the state created “a written decision on the merits” of the activity being regulated.<sup>92</sup>
- Undertake “a specific assessment—both qualitative and quantitative—of how private action comports with the substantive standards established by the state legislature.”<sup>93</sup>

In light of these three considerations, to demonstrate active supervision under the FTC’s test, a private party claiming the immunity would have to show that:

- State officials engaged in a “pointed re-examination” of the private conduct.<sup>94</sup>
- The state exercised “ultimate control” over the challenged anticompetitive conduct.<sup>95</sup> For example, 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 by agreement among private parties.”<sup>96</sup>
- The state agency has ascertained the relevant facts, examined the substantive merits of the private action, assessed whether it comports with the underlying statutory criteria, and ruled on the merits of the private action in a way sufficient

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<sup>90</sup> See Trans. at 9 (Ohlhausen). This proposal was deemed “valid” by The American Antitrust Institute. See AAI Comments, at 7.

<sup>91</sup> See *FTC State Action Report*, at 55; *Indiana Household Movers and Warehousemen, Inc.*, Docket No. C-4077, at 5 (April 25, 2003) (Analysis to Aid Public Comment) (“*Indiana Household*”), available at <http://www.ftc.gov/os/2003/03/indianahouseholdmoversanalysis.pdf>.

<sup>92</sup> See *FTC State Action Report*, at 55; *Indiana Household*, at 5.

<sup>93</sup> See *FTC State Action Report*, at 55; *Indiana Household*, at 5.

<sup>94</sup> See *FTC State Action Report*, at 53; *Midcal*, 445 U.S. at 106; *Ticor*, 504 U.S. at 634-35; *Patrick*, 486 U.S. at 100-01.

<sup>95</sup> *Patrick*, 486 U.S. at 101; see also *FTC State Action Report*, at 53.

<sup>96</sup> See *FTC State Action Report*, at 53-54; *Ticor*, 504 U.S. at 634-35.

to establish the challenged conduct as a product of deliberate state intervention rather than private choice.<sup>97</sup>

Some AMC witnesses and other commenters criticized this proposal on the following grounds:

- The proposal does not comport with *Ticor*.<sup>98</sup> The procedural elements of the test—namely that there be adequate notice, an opportunity to be heard, and a written opinion—resuscitate a procedurally oriented active supervision test advanced by the Bureau of Competition (and rejected by the Commission) in *Ticor*.<sup>99</sup> Nothing the Supreme Court wrote in *Ticor* would change the validity of the Commission’s rejection of a procedurally oriented standard.<sup>100</sup> In fact, given the Court’s disavowal of any requirement that there be any particular form of state regulation, there is reason to believe that the *Ticor* Court might well have rejected such a standard.
- The FTC standard appears to beg a later assessment of how well the state regulators performed by a measure yet to be determined—an “adequate” factual record, a written decision “on the merits,” and a specific “qualitative and quantitative” assessment.<sup>101</sup> The *Ticor* Court can be read as having rejected later federal second-guessing about the quality of a state’s supervision.<sup>102</sup> Several lower courts have suggested that *Ticor* does not require a qualitative evaluation of how well regulators did their job.<sup>103</sup>
- The proposal is not sufficiently sensitive to principles of state sovereignty and federalism.<sup>104</sup>
- The proposal adds uncertainty to the application of the state action doctrine.<sup>105</sup>
- The proposal requires too much; the element calling for specific assessment is all that is necessary.<sup>106</sup>

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<sup>97</sup> See *FTC State Action Report*, at 54.

<sup>98</sup> See Christie Statement, at 13.

<sup>99</sup> See *id.* at 13-14; *In the Matter of Ticor Title Ins. Co.*, 112 F.T.C. 344 (1989), WL1126786, at \*44-45.

<sup>100</sup> See Christie Statement, at 14.

<sup>101</sup> *Id.* (citing *FTC State Action Report*, at 52-55).

<sup>102</sup> See *id.* at 14-15.

<sup>103</sup> See, e.g., *Gulf Marine Repair Corp. v. Liberty Mut. Ins. Co.*, 1995-1 Trade Cas (CCH) ¶ 70,968 (M.D. Fla. 1995); *Ehlinger & Assoc. v. Louisiana Architects Assoc.*, 989 F. Supp. 775, 784 (E.D. La. 1998).

<sup>104</sup> See Christie Statement, at 13.

<sup>105</sup> See *id.* at 16.

- The FTC’s own application of the standard shows how confusing and unworkable it is. In four cases following issuance of the Staff Report, the FTC makes no “meaningful recitation of facts describing the state’s involvement in rate-setting or any reasoning behind the FTC conclusion that active supervision did not exist.”<sup>107</sup> In only two cases did the FTC include some discussion of its perception of the facts and why the standard was not met, but even there, the discussion was abbreviated.<sup>108</sup>
- May require costly case-by-case adjudication to implement.<sup>109</sup>

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<sup>106</sup> See Varner Statement, at 19 (FTC standard is “unrealistic and perhaps draconian”).

<sup>107</sup> Christie Statement, at 10; Varner Statement, at 3; Trans. at 27-28 (Varner); see also *In the Matter of Indiana Household Movers and Warehousemen, Inc.*, Analysis of Proposed Consent Order to Aid Public Comment, 68 Fed. Reg. 14,234 (Mar. 24, 2003); *In the Matter of Minnesota Transport Services Association*, Analysis of Proposed Consent Order to Aid Public Comment, 68 Fed. Reg. 47,571 (Aug. 11, 2003); *In the Matter of Iowa Movers and Warehousemen’s Association*, Analysis of Proposed Consent Order to Aid Public Comment, 68 Fed. Reg. 47,568 (Aug. 11, 2003); *In the Matter of New Hampshire Motor Transport Association*, Analysis of Proposed Consent Order to Aid Public Comment, 68 Fed. Reg. 62,606 (Nov. 5, 2003).

<sup>108</sup> See Christie Statement, at 10-11; see also *In the Matter of Alabama Trucking Association, Inc.*, Analysis of Proposed Consent Order to Aid Public Comment, 68 Fed. Reg. 62,597 (Nov. 5, 2003) (finding no active supervision because no written decision approving the rates, no consistent public notice and hearing, no evidence that the state had done research into the economic conditions of the industry or independently verified the accuracy of data, and no evidence demonstrating the process by which the state determined that the rates met the statutory criteria); *In the Matter of Movers Conference of Mississippi, Inc.*, Analysis of Proposed Consent Order to Aid Public Comment, 68 Fed. Reg. 62,601 (Nov. 5, 2003) (finding no active supervision because, although the state had conducted some verification of costs generally, it did not do the necessary research into the economic conditions of the industry; moreover, “the mere fact of a hearing will not establish active supervision,” and the written opinion was insufficiently analytical to meet the FTC threshold).

Although DOJ has been less active in the state action arena, a recent competitive impact statement filed in support of a proposed consent decree resolving a complaint against two West Virginia hospitals suggests that it accepts at least some of the elements of the FTC Report’s formulation for active supervision. See *United States v. Bluefield Reg’l Med. Ctr., Inc.*, Civ. Action No. 1:05-0234 (S.D. W. Va.) (Sept. 12, 2005). The DOJ Statement recites that a West Virginia state health care authority has not purported to actively supervise the defendants’ agreements “as it did not (1) develop a factual record concerning the initial or ongoing nature and effect of the agreements; (2) issue a written decision approving the agreements; or (3) assess whether the agreements further criteria established by the West Virginia legislature.” *Id.*, Competitive Impact Statement, at 11 (March 21, 2005).

<sup>109</sup> See ABA State Action Comments, at 18.

2. *Tiered approach with different requirements based on situation*

Critics have argued that the FTC report proposes a too rigid standard that takes a “one size fits all” approach.<sup>110</sup> As the ABA noted, “what is sufficiently ‘active’ for active supervision will vary based on the conduct, industry, regulatory scheme, as well as other factors.”<sup>111</sup> Instead, the ABA proposes a “tiered” approach as a more flexible standard under which states are afforded appropriate latitude in structuring regulatory schemes.<sup>112</sup> The appropriate level of supervision would depend on the facts and circumstances of the conduct.<sup>113</sup>

- No active supervision should be required as to agencies that are part of the state under its constitution and statutes.<sup>114</sup>
- Active supervision should apply to any entity consisting in whole or in part of market participants.<sup>115</sup> 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>116</sup> When there is a hybrid public-private entity, if the majority of the decision-making entities within the hybrid are private market participants, regular reauthorization of the state action immunity by the legislature should be required.<sup>117</sup> A further requirement is that the active supervision be performed by a governmental official or entity outside the entity in question.<sup>118</sup>

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<sup>110</sup> Christie Statement, at 16 (“Genuine state regulation can take many different forms and any standard of active supervision must recognize that fact.”); Varner Statement, at 19; *see also* Trans. at 31 (Christie) (“I find it very difficult to embrace, in the abstract, a concept of active supervision that I’m comfortable leaves potential regulatory activity that’s genuine and participatory in, and all that’s un-genuine and un-participatory out.”).

<sup>111</sup> *See* ABA State Action Comments, at 17.

<sup>112</sup> *See* Christie Statement, at 16 (“Genuine state regulation can take many different forms and any standard of active supervision must recognize that fact.”); Varner Statement, at 19.

<sup>113</sup> *See* ABA State Action Comments, at 17; *Ticor*, 504 U.S. at 634-35.

<sup>114</sup> *See* Varner Statement, at 20.

<sup>115</sup> *See* *FTC State Action Report*, at 55; ABA State Action Comments, at 15; *see also* Trans. at 26 (Varner).

<sup>116</sup> *See* *FTC State Action Report*, at 55; Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law: An Analysis of Antitrust Principles and Their Application* 501 (2d ed. 2000) (“Areeda & Hovenkamp, *Antitrust Law*”); *see also* AAI Comments, at 8.

<sup>117</sup> *See* ABA State Action Comments, at 19-20.

<sup>118</sup> *See* *FTC State Action Report*, at 56; *see also* AAI Comments, at 8-9.

- However, others argue that the same standard should be applied to all entities, or at least the criteria for identifying the *quasi*-governmental entities that should be subject to active supervision should be clarified and rationalized.<sup>119</sup>
- Require a 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.<sup>120</sup> This would consider factors such as the entity’s structure, membership, decision-making apparatus, and openness to the public.<sup>121</sup> It would also look at the degree of discretion private actors had to make the challenged decision.<sup>122</sup>
  - However, others view this proposal as “difficult to carry out” and “doomed to failure.”<sup>123</sup> “[I]t verges on saying there is something wrong with private actors pursuing their private interests within a democratic polity.”<sup>124</sup>
- 3. *Eliminate damages liability when private parties act in “good faith” to comply with terms of regulation*

Two witnesses favored eliminating liability for damages for actors who acted in good faith pursuant to state regulation.<sup>125</sup> By limiting liability in many situations, the precise contours of the clear articulation prong would have reduced significance, and the lack of clarity would not impose on parties the risk of treble damages when acting pursuant to state law.<sup>126</sup> One witness responded that such a rule would encourage private entities to get anticompetitive state

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<sup>119</sup> See *FTC State Action Report*, at 37; Trans. at 9 (Ohlhausen).

<sup>120</sup> See *FTC State Action Report*, at 37.

<sup>121</sup> See *id.*

<sup>122</sup> See *id.* at 56; see also Areeda & Hovenkamp, *Antitrust Law*, at 501.

<sup>123</sup> AAI Comments, at 9.

<sup>124</sup> *Id.*

<sup>125</sup> See Trans. at 57 (Langer); Trans. at 58-59 (Varner). A variation on this proposal would be to create a safe harbor for parties who meet certain requirements. See Trans. at 53 (Ohlhausen).

<sup>126</sup> See Trans. at 53 (Ohlhausen).

regulations passed because there would be almost no repercussions for acting pursuant to that state regulation.<sup>127</sup>

### C. Creation of a market participant exception

The FTC Report proposed that courts create an exception to the state action doctrine for municipalities acting as market participants.<sup>128</sup> Pursuant to *Town of Hallie v. City of Eau Claire*, municipalities acting pursuant to state law are not subject to the active-supervision prong of the state action doctrine.<sup>129</sup> A market participant exception would make a municipality potentially liable for anticompetitive conduct if it is acting as a “market participant”—that is, if it is engaged in conduct “as a commercial participant in the relevant market”—*unless* its conduct is actively supervised by the state.<sup>130</sup>

One witness proposed that any market participant exception should also extend to state governmental entities currently immune from liability.<sup>131</sup>

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- Such an exception would constrain municipalities when they act as competitors with private businesses.<sup>132</sup> Municipalities are engaging in increasing amounts of

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<sup>127</sup> See Trans. at 58 (Ohlhausen).

<sup>128</sup> See *FTC State Action Report*, at 15-16; see also 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) (“Ponsoldt, *Federalism*”); Langer Statement, at 2; Trans. at 21 (Langer).

<sup>129</sup> *Town of Hallie*, 471 U.S. at 47 (“Once it is clear that the 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.”); see *FTC State Action Report*, at 15-16.

<sup>130</sup> *FTC State Action Report*, at 45.

<sup>131</sup> See Langer Statement, at 3. This would subject state market participation to federal antitrust scrutiny. See *id.* Langer argues that because the Eleventh Amendment concerns only private actions against the state itself (and not, therefore, any actions by the federal antitrust agencies), and has fundamental concerns different from those of the antitrust laws, such an exception is not at odds with *College Savings Bank*. See *id.*

<sup>132</sup> See *id.*; Trans. at 21-22 (Langer).

commercial activity, but are using their law-making power to exclude competitors.<sup>133</sup> Absent antitrust constraints, municipalities may lead to conflicting regulatory regimes that may undermine the free-market system beyond the boundaries of the municipality.<sup>134</sup>

- The Supreme Court and several courts of appeals have suggested that a market participant exception exists or should be recognized.<sup>135</sup>
- Extending the market participant exception to states, in addition to municipalities, would help extend the purposes of the antitrust laws fully.<sup>136</sup> Extension of the antitrust laws to states themselves would eliminate the current existing gap where states are constrained neither by the antitrust laws nor by the dormant Commerce Clause, which is not applicable to states when they are acting as competitors in a market.<sup>137</sup>
- Limiting application of the market participant exception to situations in which the government engages in horizontal competition with private firms in the sale of some product or service could limit any problems of difficult line-drawing.<sup>138</sup>
- Extending the market participant exception to state government has precedent in other areas of sovereign immunity. In particular, there are commercial activity exceptions to other sovereign immunities.<sup>139</sup>

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<sup>133</sup> *FTC State Action Report*, at 44 (citing Ponsoldt, *Federalism*).

<sup>134</sup> *Id.* at 45.

<sup>135</sup> *See id.* at 46-48; Robert M. Langer, *Can the King's Physician (Also) Do No Wrong? Health Care Providers and a Market Participation Exception to the State Action Immunity Doctrine*, Antitrust Report, at 15-16 (Oct. 1999) ("Langer, *King's Physician*"); *Parker*, 317 U.S. at 351-52 ("True, a state does not give immunity those who violate the Sherman Act by authorizing them to violate it, or by declaring that their action is lawful, and we have no question of the state or its municipality becoming a participant in a private agreement or combination by others for restraint of trade."); *City of Lafayette*, 435 U.S. at 418 (Burger, C.J., concurring) ("There is nothing in *Parker* . . . or its progeny, which suggests that a proprietary enterprise with the inherent capacity for economically disruptive anticompetitive effects should be exempt from the Sherman Act merely because it is organized under state law as a municipality."); *City of Columbia v. Omni Outdoor Advertising, Inc.*, 499 U.S. 365, 379 (1991) ("with the possible market exception, any action that qualifies as state action is *ipso facto* . . . exempt from the operation of the antitrust laws.").

<sup>136</sup> Langer Statement, at 3.

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

<sup>138</sup> *See Areeda & Hovenkamp, Antitrust Law*, at 436.

<sup>139</sup> *See Langer, King's Physician*, at 19 (discussing commercial activity exceptions to foreign sovereign immunity and act of state doctrine); *see also Alfred Dunhill of London, Inc. v. Republic of Cuba*, 425 U.S. 682, 695-706 (1976) (holding the act of state doctrine inapplicable to the repudiation of a commercial debt by an instrumentality of the Cuban government). This

## Cons

- A market participation exception is “a difficult line to draw, and probably best handled by a regular reauthorization of the state action immunity by the legislature rather than case by case with respect to all business decisions of the government entity.”<sup>140</sup> For example, the Supreme Court in *Garcia v. San Antonio Metropolitan Transit Authority* rejected “as unsound in principle and unworkable in practice, a rule of state immunity from federal regulation that turns on a judicial appraisal of whether a particular governmental function is ‘integral’ or ‘traditional.’”<sup>141</sup>
- A market participant exception to the state action doctrine that applied to states would be limited by the Eleventh Amendment. Private parties are limited in their enforcement of the antitrust laws against states because there is no market participant exception to the Eleventh Amendment.<sup>142</sup> The federal government

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exception has enjoyed support in the lower courts, and has been incorporated into the 1995 Department of Justice and Federal Trade Commission Antitrust Enforcement Guidelines for International Operations. *See, e.g., Hunt v. Mobil Oil Corp.*, 550 F.2d 68, 73 (2d Cir. 1977); *Walter Fuller Aircraft Sales, Inc. v. Republic of the Philippines*, 965 F.2d 1375, 1388 (5th Cir. 1992); *Northrop Corp. v. McDonnell Douglas Corp.*, 705 F.2d 1030, 1048 & n.25 (9th Cir. 1983); *see also* U.S. Dept. of Justice & Federal Trade Commission, Antitrust Enforcement Guidelines for International Operations § 3.33 (1995).

<sup>140</sup> *See* Varner Statement, at 21; *see also* *FTC State Action Report*, at 49; ABA State Action Comments, at 20; Trans. at 47 (Varner); Trans. at 46-47 (Langer).

<sup>141</sup> 469 U.S. 528, 546-47 (1985). A majority of lower federal courts have also rejected a market participation exception to state action immunity. *See, e.g., Automated Salvage Transp., Inc. v. Wheelabrator Env'tl. Sys., Inc.*, 155 F.3d 59, 79-80 (2d Cir. 1998); *FTC v. Hospital Bd. of Directors of Lee Cty.*, 38 F.3d 1184, 1192 (11th Cir. 1994); *Paragould Cablevision, Inc. v. City of Paragould*, 930 F.2d 1310, 1312-13 (8th Cir. 1991); *Lancaster Comty. Hosp. v. Antelope Valley Hosp. Dist.*, 940 F.2d 397, 402 & n.9 (9th Cir. 1991); *Allright Colo., Inc. v. City & Cty. of Denver*, 937 F.2d 1502, 1510 (10th Cir. 1991); *Limeco, Inc. v. Division of Lime of Miss. Dep't. of Agric. & Commerce*, 778 F.2d 1086, 1087 (5th Cir. 1985). *But see Genentech, Inc. v. Eli Lilly and Co.*, 998 F.2d 931, 948 (Fed. Cir. 1993) (“To warrant *Parker* immunity the anticompetitive acts must be taken in the state’s ‘sovereign capacity,’ and not as a market participant in competition with commercial enterprise.”); *see also* Varner Statement, at 21 (stating that Congress also rejected a market participation exception when enacting the Local Government Antitrust Act (citing 1984 U.S.C.C.A.N. 4615-16)).

<sup>142</sup> *See* Langer Statement, at 3; *see also* *College Savings Bank v. Florida Prepaid Postsecondary Educ. Expense Bd.*, 527 U.S. 666 (1999). However, this counsels in favor of a market participant exception to the state action doctrine. *See* Langer, *King’s Physician*, at 20. In that case, the Court declined to apply the exception to state sovereign immunity because the Eleventh Amendment was not designed with principles of evenhandedness at its core. *See id.* However, the antitrust laws *are* designed with principles of evenhandedness at their core, making them a perfect example of where a market participant exception is necessary. *See id.*

alone would be able to enforce the antitrust laws against the states when they acted as market participants.<sup>143</sup>

D. Creation of an interstate spillovers exception

The FTC Report, as well as other witnesses and commenters, expressed concerns that the state action doctrine could immunize activity with significant interstate spillovers (or “negative externalities”). If a state imposes a regulatory regime that is anticompetitive, but not subject to the antitrust laws because of the state action doctrine, the costs may spill over onto citizens of other states.<sup>144</sup> For example, in *Parker*, California created a regulatory regime that had the effect of raising the price of raisins. Because nearly all raisins were exported to other states, consumers in those states bore the principal burden of those increased prices.<sup>145</sup> The burdens of such spillovers thus fall mainly on those who did not participate in the political process by which the regulations were adopted.<sup>146</sup>

Witnesses and commenters expressing concern with interstate spillovers did not articulate a single standard of when interstate spillovers would be sufficiently large to limit invocation of the state action immunity. One witness, for example, proposed a spillover exception applicable when the costs of a state regulatory regime are borne “primarily” by citizens of other states.<sup>147</sup>

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<sup>143</sup> See Langer Statement, at 3.

<sup>144</sup> *FTC State Action Report*, at 40.

<sup>145</sup> See *id.*

<sup>146</sup> See *id.* at 41-42. This is counter to the legislative process in general, and specifically as it is applied in the antitrust context. See, e.g., *Northern Securities Co. v. United States*, 193 U.S. 197, 343-47 (1904) (the point of national antitrust legislation is to ensure that the party regulating the activity internalizes the costs and benefits of its regulatory choices; no state may “project” its authority beyond its borders contrary to the wishes of Congress) (“*Northern Securities*”); *Addyston Pipe & Steel Co. v. United States*, 175 U.S. 211, 231-33 (1899) (Sherman Act reaches purely private cartels that restrain interstate commerce because states have improper incentives to regulate such agreements).

<sup>147</sup> See Varner Statement, at 4, 19; Trans. at 9 (Ohlhausen); Trans. at 25-26 (Varner); AAI Comments, at 8.

Another witness proposed an exception applicable when there are “overwhelming interstate spillovers.”<sup>148</sup>

Other witnesses view interstate spillovers as a factor compelling more rigorous application of the clear articulation and active supervision requirements. They called for courts at least to consider the extent of spillovers in determining whether immunity is justified.<sup>149</sup>

### Pros

- Federalism and state sovereignty do not justify the state action doctrine where the costs of the anticompetitive conduct are borne primarily by citizens of other states, and there should be an exception in those circumstances.<sup>150</sup> Interstate spillovers have both economic and political consequences.<sup>151</sup>
- Where decision-makers reap the benefits without bearing the costs of an activity, they have an incentive to engage in more of that activity than is socially desirable.<sup>152</sup>
- In particular, the state political process cannot be relied upon to protect the interests of the out-of-state buyers.<sup>153</sup> Federalism is not furthered when out-of-

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<sup>148</sup> Trans. at 9 (Ohlhausen).

<sup>149</sup> See *FTC State Action Report*, at 57.

<sup>150</sup> See Varner Statement, at 4, 19; see also *FTC State Action Report*, at 40; ABA State Action Comments, at 21; Jorde, *Return*, at 256 (“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.”); Inman & Rubinfeld, *Making Sense*, at 1271, 1276 (recommending 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.”); Herbert Hovenkamp & John A. Mackerron III, *Municipal Regulation and Federal Antitrust Policy*, 32 *UCLA L. Rev.* 719, 767-69 (1985) (a regulator whose jurisdiction is too small to extend over “the entire regulated market and the substantial portion of things affected by its externalities” is not the optimal regulator); Frank H. Easterbrook, *Antitrust and the Economics of Federalism*, 26 *J. L. & Econ.* 23, 45 (1983) (states may 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.”). One proposal would be that if a state’s effort to exempt action impacts other states more than 50% of the time, there would be no state action immunity. See Trans. at 44 (Varner).

<sup>151</sup> See *FTC State Action Report*, at 41, 56.

<sup>152</sup> See *id.*; see also Edwin Mansfield, *Microeconomics, Theory and Applications* 458 (3d ed. 1979).

state citizens adversely impacted by spillovers are effectively disenfranchised on the issue.<sup>154</sup>

### Cons

- It is difficult to come up with a workable standard to implement a spillover exception.<sup>155</sup> As described above, witnesses and commenters expressing concern with interstate spillovers did not articulate a clear standard of when interstate spillovers would be sufficiently large to warrant limitation of the state action immunity.

#### E. Statutory changes to codify the state action doctrine

Some suggest that the federal state action doctrine be codified. The witness proposing this approach suggested that a statute passed by Connecticut could provide a useful model.<sup>156</sup>

That law provides:

Nothing contained in this chapter shall apply to those activities of any person when said activity is specifically directed or required by a statute of this state, or of the United States.<sup>157</sup>

Congress likely has the power under the Constitution to extend the Sherman Act to bar activities otherwise authorized by state legislation, where such activities are in or affecting interstate commerce.<sup>158</sup>

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<sup>153</sup> See Varner Statement, at 19.

<sup>154</sup> See *FTC State Action Report*, at 41-42; Inman & Rubinfeld, *Making Sense*, at 1271; Jorde, *Return*, at 253; Trans. at 25-26 (Varner).

<sup>155</sup> See Varner Statement, at 4, 19; ABA State Action Comments, at 21-22.

<sup>156</sup> See Langer Statement, at 5; Conn. Gen. Stat. § 35-31(b).

<sup>157</sup> Conn. Gen. Stat. § 35-31(b).

<sup>158</sup> See, e.g., *Houston E. & W. Tex. Ry. v. United States*, 234 U.S. 342, 354 (1914) (“Nor can the attempted exercise of state authority alter the matter, where Congress has acted, for a State may not authorize the carrier to do that which Congress is entitled to forbid and has forbidden.”); see also *Northern Securities*, 193 U.S. at 343-47 (rejecting claim that Tenth Amendment prevented Sherman Act scrutiny of merger between two New Jersey corporations that conducted interstate railroad business); *Gibbons v. Ogden*, 22 U.S. 1 (1824) (Congress preempted state-created monopoly via Federal Navigation Act). Congress need only expressly state its intent that national antitrust policies supersede federalism concerns. See *Parker*, 317 U.S. at 350-51.

However, there are those who are skeptical that codification will help.<sup>159</sup> Likewise, the FTC Report did not call for statutory change.<sup>160</sup> Rather, its recommendations were directed towards ways courts should approach application of the doctrine to serve its core purpose, and ways the Federal Trade Commission could help move the doctrine's application in the appropriate direction, through *amicus* briefs and administrative litigation.<sup>161</sup>

#### Pros

- A statute provides greater clarity and transparency.<sup>162</sup>
- Ensures a uniform application of the doctrine by eliminating differing approaches between circuit courts.<sup>163</sup>

#### Cons

- Should views as to the appropriate scope of the state action immunity change, it would require statutory amendment.<sup>164</sup>
- Application of the statute would likely require judicial interpretation, potentially leading to unclear standards or standards that differ across circuits.

### **III. Local Government Antitrust Act**

Congress passed the Local Government Antitrust Act of 1984 (“LGAA”)<sup>165</sup> following the Supreme Court’s ruling in *Community Communications Co. v. City of Boulder*, where the Court narrowed the exemption available to a state’s political subdivisions.<sup>166</sup> Congress was concerned that local government officials could be subject to treble damages as a result of merely

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<sup>159</sup> See Trans. at 36-37 (Varner).

<sup>160</sup> *FTC State Action Report*, at 50 (“The Task Force has not considered the wisdom or practicality of any such fundamental challenge to [the] state action doctrine.”).

<sup>161</sup> See *id.* at 50-58.

<sup>162</sup> See Langer Statement, at 5.

<sup>163</sup> See Trans. at 32-33 (Varner).

<sup>164</sup> See Trans. at 32-33 (Langer).

<sup>165</sup> 15 U.S.C. §§ 34-36 (2000).

<sup>166</sup> 455 U.S. 40 (1982).

performing core government functions, which could threaten municipal finances and discourage public service.<sup>167</sup> The LGAA expressly bars antitrust damage actions against local governments.<sup>168</sup> Local governments are defined as “a city, county, parish, town, township, village, or any other general function governmental unit established by State law or . . . a school district, sanitary district, or any other special function governmental unit established by State law in one or more States.”<sup>169</sup> The LGAA also precludes the recovery of antitrust damages from any local government official or employee “acting in an official capacity,”<sup>170</sup> and from any private party “based on any official action directed by local government.”<sup>171</sup>

Witnesses and commenters identified two principle problems with the LGAA.

- Providing only injunctive relief is not a significant deterrent to anticompetitive conduct by local governments.<sup>172</sup>
- The LGAA has operated to prevent plaintiffs from obtaining injunctive relief, even though it does not bar such relief.<sup>173</sup> The immunity “by proximity neuters the deterrence effect” of private plaintiffs’ antitrust actions.<sup>174</sup>

Commenters proposed two possible reforms to the LGAA: Addition of an active supervision prong and revision to provide for single damages in addition to injunctive relief.

- Addition of an active supervision prong: The LGAA does not have clear articulation or active supervision prongs.<sup>175</sup> Some propose adding those

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<sup>167</sup> See 1984 U.S.C.C.A.N. 4602, 4603-11 (1984).

<sup>168</sup> See 15 U.S.C. §§ 34-36 (2000).

<sup>169</sup> 15 U.S.C. § 34(1).

<sup>170</sup> 15 U.S.C. § 35(a).

<sup>171</sup> 15 U.S.C. § 36(a).

<sup>172</sup> See Varner Statement, at 3, 16; Trans. at 41 (Varner).

<sup>173</sup> See AAI Comments, at 9.

<sup>174</sup> See *id.* A 2000 study found that in only two cases did courts grant injunctions where the court considered application of the LGAA. See E. Thomas Sullivan, *Antitrust Regulation of Land Use: Federalism’s Triumph Over Competition, The Last Fifty Years*, 3 Wash. U. J. L. & Pol’y 473, 511 n.196 (2000).

<sup>175</sup> See AAI Comments, at 12.

requirements. Adding an active supervision requirement would ensure that the municipality's behavior is consistent with state policy.<sup>176</sup>

- Revision to provide for single damages in addition to injunctive relief: Two witnesses proposed modifying the LGAA to provide that local government entities are subject to single damages, in addition to the injunctive relief to which they are already subject.<sup>177</sup> Limiting relief to single (not treble) damages would reduce the concern that damages could drain the public treasury and discourage public service.<sup>178</sup> It would, however, provide a more effective deterrent than only injunctive relief.<sup>179</sup> Detrebling of this sort would be similar in principle to the detrebling provisions in the National Cooperative Research and Production Act of 1993 and the Standards Development Organization Advancement Act.<sup>180</sup>

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<sup>176</sup> See *FTC State Action Report*, at 57.

<sup>177</sup> See Varner Statement, at 3, 16; Trans. at 48 (Varner); Trans. at 48 (Langer); Trans. at 49-50 (Ohlhausen).

<sup>178</sup> See Varner Statement, at 16 n.22.

<sup>179</sup> See *id.* at 16.

<sup>180</sup> See *id.* (citing 15 U.S.C. § 4301-05).