Federal Trade Commission

Returning the State Action Doctrine to Its Moorings

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Since our Constitutional founding, political power has been divided between the federal government on the one hand and the states on the other. The basic principle of American federalism is fixed in the Tenth Amendment to the Constitution, which states that "The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people." In the early years of our Republic, the federal government focused on a handful of functions, including defense, foreign affairs, collection of tariffs, control of currency, and public works. Over time, the federal government's role has expanded and now touches on nearly all aspects of life for American citizens. This has

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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, Darren Tucker, for his invaluable assistance in preparing this speech.

hardly ended the debate, however. As the current Presidential campaign makes clear, our

interstate commerce."[3] Then, five years later in the *Morrison* case,[4] the Court concluded that a statute providing for a federal cause of action for the victims of gender-motivated violence was also beyond Congress's commerce power. The Court explained that "[g]ender-motivated crimes of violence are not, in any sense of the phrase, economic activity."[5] Nevertheless, in its 2005 opinion in *Gonzales v. Raich*,[6] the Court held that growing marijuana for personal medical use was sufficiently close to "commerce" to justify a federal ban. Most recently, the Court held that the individual mandate in ObamaCare exceeded Congress's powers under the Commerce Clause (but upheld it under Congress's taxing power).[7] As the Court explained, the "individual mandate cannot be upheld as an exercise of Congress's power under the Commerce Clause. That Clause authorizes Congress to regulate interstate commerce, not to order individuals to engage in it."[8]

The State Action Doctrine

Recognition of the limits of federal power over the states can also be seen in the Supreme Court's interpretation of the federal antitrust laws. This line drawing between state and federal power is necessary in the area of antitrust enforcement because state and local governments often enact statutes that restrict competition and would violate the antitrust laws if done by a private entity. New York City's cap on the number of taxi medallions it issues is one example; another example you should all be able to relate to are state bar associations, because these restrict the number of people that can practice law.

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[3] *Id.* at 567.

[4] *United States v. Morrison*, 529 U.S. 598 (2000).

[5] *Id*. at 613.

[6] 545 U.S. 1 (2005).

[7] *Nat'l Fed'n of Indep. Bus. v. Sebelius*, 132 S. Ct. 2566 (2012).

[8] *Id.* at 2608.

In its 1943 *Parker v. Brown* decision,[9] the Supreme Court recognized the potential constitutional concerns raised by interpreting the federal antitrust laws to reach actions of states. The *Parker* case involved a challenge to a California regulatory system that restricted competition among growers of certain agricultural products for the express purpose of increasing prices and increasing the agricultural wealth of the state. Although such a program would undoubtedly violate the Sherman Act if done by private persons, the Court held that California's program was not a conspiracy in restraint of trade because the antitrust laws did not "restrain state action or official action directed by a state."[10] As the Court explained, "[w]e 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 its legislature."

> will serve to make clear that the State is responsible for the price fixing it has sanctioned and undertaking to control.[20]

The state action doctrine is also available to municipalities. For a municipality to qualify for the state action defense, it must "demonstrate that it is engaging in the challenged activity pursuant to a clearly expressed state policy."[21] Unlike the state itself, municipalities are not entitled to automatic state action protection because municipalities are not sovereign and do not receive the same degree of federal deference given to the states that create them. Municipalities are not, however, subject to *Midcal*'s active supervision prong.[22] Unlike the case of a private party where "there is a real danger that he is acting to further his own interests, . . . there is little or no danger that [a municipality] is involved in a *private* price-fixing agreement."[23]

The Supreme Court has not ruled on the circumstances under which state action protection is available to state agencies. In a footnote, the Court suggested that clear articulation but not active supervision would be required for state agencies.[24] Nevertheless, several courts of appeals have held that acts of executive departments and state agencies are those of the sovereign and therefore are exempt from the antitrust laws without further inquiry.[25] The courts have been less than consistent with respect to the treatment of special-purpose regulatory agencies, such as professional licensing boards. Some appellate courts have held that these entities are entitled to

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[20] *Ticor*, 504 U.S. at 636.

[21] *Town of Hallie*, 471 U.S. at 40.

[22] *Id.* at 46.

[23] *Id.* at 47 (emphasis in original); s*ee also id.* at 45 ("We may presume, absent a showing to the contrary, that the municipality acts in the public interest. A private party, on the other hand, may be presumed to be acting primarily on his or its own behalf.").

[24] *Id*. at 46 n.10.

[25] *See, e.g*., *Sanders v. Brown*, 504 F.3d 903, 918 (9th Cir. 2007) (state attorney general); *Neo Gen Screening, Inc. v. New England Newborn Screening Program*, 187 F.3d 24, 28-29 (1st Cir. 1999) (officials of the executive branch).

Parker immunity, regardless of whether their actions were contemplated by the legislature.[26] Other decisions require the agency's actions to be pursuant to state policy in order for the exemption to apply.[27]

So to summarize, the actions of the sovereign – meaning the legislature, state supreme court, and perhaps the governor and executive agencies – are entitled to immunity under the state action, or *Parker*, doctrine without further inquiry. Municipalities qualify for the state action defense if the challenged restraint satisfies the clear articulation requirement. Private conduct qualifies as state action only if both the clear articulation and active supervision requirements are met. The standards for subordinate state entities to qualify for the state action defense are less clear and may depend on the particular characteristics of the entity.

The FTC's State Action Report

Over a decade ago, the FTC became concerned that the lower courts had expanded the scope of the state action doctrine beyond what the Supreme Court had intended. In 2001, the FTC established a State Action Task Force, which issued a Report two years later that analyzed the current state of the law, identified areas of concern, and recommended clarifications to the law.[28] The Report observed that the scope of the state action doctrine had expanded dramatically since first articulated by the Supreme Court in 1943. The doctrine had become unmoored from

[26] *See, e.g.*, *Green v. State Bar*, 27 F.3d 1083, 1087 (5th Cir. 1994) (state committee on unauthorized practice of law); *Berger v. Cuyahoga Cnty. Bar Ass'n*, 983 F.2d 718, 722 (6th Cir. 1993) (state bar association); *Charley's Taxi Radio Dispatch v. SIDA of Haw., Inc.*, 810 F.2d 869, 876 (9th Cir. 1987) (state department of transportation).

[27] *See, e.g.*, *Earles v. State Board of Certified Public Accountants*, 139 F.3d 1033, 1040-41 ntp 1 .0001acj/TT9 ga Cnty. Bar Ass'n

its original objectives, the report concluded, and was frequently invoked to protect private commercial interests with no relation to state policy.

The report identified a number of specific concerns with the way in which some lower courts had applied the state action doctrine. Chief among these was a persistent weakening of the clear articulation and active supervision requirements.

In particular, some courts had found that a legislative grant of general corporate powers satisfied the clear articulation requirement. Although the exercise of these powers in the private sector had no particular antitrust significance, some courts had reached the opposite conclusion when the powers were granted through legislation.

The Report also found that there was a lack of clear standards to guide the application of the active supervision requirement. Without guidance on how to implement the various formulations of the requirement articulated by the lower courts, the active supervision requirement had had a minimal impact.

The Task Force raised several other concerns. Some courts, according to the Report, had interpreted the state action doctrine in a manner that ignored interstate spillovers, which forced the citizens of one state to absorb the costs imposed by another state's regulations. In addition, some courts had interpreted the doctrine to shield virtually any municipal activity, despite the fact that municipalities were increasingly engaging in business on a for-profit basis, while simultaneously using their law-making power to block competitive challenges.

To address these concerns, the Report recommended a number of specific clarifications to the doctrine. First, the clear articulation standard should be tailored to its original purposes and goals. An appropriate clear articulation standard would ask both whether the state authorized the conduct at issue and whether the state deliberately adopted a policy to displace

competition in the manner at issue. This approach would help make clear that mere authorization is not enough.

Second, the standards for active supervision should be clarified and strengthened. The Supreme Court provided little guidance on the kind of review of private actions that would constitute "active" supervision. The Report recommended a number of factors for the courts to consider considered when determining whether private conduct should be attributed to the state.[29]

Third, the criteria for identifying the entities that should be subject to active supervision should be clarified. The Report recommended that the active supervision requirement apply to any entity consisting of market participants or to any situation with an appreciable risk that the challenged conduct resulted from private actors' pursuing private interests.

Fourth, courts should recognize the problems associated with interstate spillovers, and consider such spillovers as a factor. When one state regulates activities in a way that imposes most of the costs of regulation on citizens of other states, both economic efficiency and the political participation goal of federalism are impaired. The Report recognized that this recommendation was more aspirational than the others because the Supreme Court's *Parker* decision shielded conduct that resulted in substantial interstate spillover.

FTC Enforcement Actions Involving the State Action Doctrine

Both before and after the issuance of the State Action Report, the FTC has sought to clarify the state action doctrine by bringing administrative and federal court cases, filing amicus briefs, and engaging in competition advocacy efforts at the state level. Three litigated FTC cases

[29] The key factors identified were (1) the development of an adequate factual record, including notice and an opportunity to be heard; (2) a written decision on the merits; (3) and a specific assessment of how private action comports with the substantive standards established by the state legislature. *See id.* at 55.

stand out as particularly noteworthy: *South Carolina Dental*, *North Carolina Dental*, and *Phoebe Putney*.

The *South Carolina Dental* case involved efforts by the South Carolina State Board of Dentistry to restrict competition for dental hygienist services. In 2000, the South Carolina legislature eliminated a statutory requirement that a dentist examine a child before a hygienist could perform preventive dental care in a public health setting. The goal was to increase access to preventive dental care, particularly for low-income families.

In July 2001, however, the Dental Board adopted an emergency regulation that re-imposed the dentist examination requirement. The Board then published a proposal to adopt the dentist examination requirement as a permanent regulation.[30]

In September 2003 – the same month that the FTC released its State Action Report – the FTC issued an administrative complaint against the Dental Board alleging that it violated the antitrust laws by restricting the ability of dental hygienists to provide preventive dental services to children in South Carolina schools.[31] Through its actions, the Dental Board deprived thousands of school children – particularly poor children – of preventive oral health care.

The Dental Board filed a motion to dismiss the action on the ground that its actions were protected by the state action doctrine.[32] Although the Dental Board was an instrumentality of the

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[30] A South Carolina administrative law judge determined that the Board's dentist examination requirement was unreasonable and contravened state policy because it reinstated requirements that the General Assembly had removed. The General Assembly also passed a new statute effectively reversing the Dental Board's regulation. After the ALJ's decision, the Board abandoned its attempt to make the regulation permanent.

[31] Complaint, South Carolina State Board of Dentistry, Docket No. 9311 (Sept. 15, 2003), *available at* http://www.ftc.gov/os/2003/09/socodentistcomp.pdf.

[32] The Board also argued that the Commission's case was moot because the 2001 emergency regulation had expired and that the 2003 amendments to the state law barred the reimposition of the preexamination requirement. The Commission concluded that whether the Board may engage in such anticompetitive conduct again raised factual issues that could not be resolved in a motion

state, the FTC held that it did not qualify for the state action doctrine because it was not acting pursuant to any clearly articulated state policy to displace competition.[33] To the contrary, its actions contravened the clear legislative intent in the 2000 legislation to eliminate the preexamination requirement. In reaching this conclusion, the Commission held that "subordinate" special-purpose agencies or industry regulatory bodies, like the Dental Board, must satisfy the clear articulation requirement to qualify for state action immunity.[34] The Commission also observed that the courts had consistently declined to afford automatic state action status to state licensing or regulatory boards that, like the Dental Board, were composed of members of the regulated industry. (This observation will play center stage in the next FTC state action case.)

The Board filed an appeal with the Fourth Circuit seeking an interlocutory review of the Commission's state action ruling. The Court of Appeals dismissed the appeal for lack of

condition for dental hygienists to provide dental care in public health settings.[36] To prevent similar anticompetitive conduct in the future, the order required the Dental Board to provide written notice to the FTC prior to any action of the Board relating to the provision of preventive dental services by dental hygienists in public health settings.

The next state action case the FTC brought also involved the actions of a state dental board. In July 2010, the Commission filed an administrative complaint against the North Carolina State Board of Dental Examiners, alleging that it had harmed competition by blocking non-dentists from providing teeth-whitening services in the state.[37] The FTC alleged that, in response to complaints by dentists, the Board had issued cease and desist letters to several dozen non-dentist teeth whitening service providers and distributors of teeth whitening products and equipment. In addition, the Board sent letters to mall owners and operators urging them not to lease space to non-dentist teeth whitening providers.

As a result of the Board's actions, many non-dentists stopped providing teeth whitening services and several marketers of teeth whitening systems stopped sel

Applying the *Midcal* test, the Commission concluded that the State had not actively supervised the challenged conduct of the Dental Board. As the Commission Opinion pointed out, there was no evidence that "a state actor was even aware of the Board's policy toward non-dentist teeth whitening, let alone reviewed or approved it."[43] The Commission rejected the Dental Board's argument that the filing of annual reports and financial disclosures with various state agencies was sufficient because "[t]his sort of generic oversight . . . does not substitute for the required review and approval of the 'particular anticompetitive acts' that the complaint challenges."[44]

Of course, the Commission's decision that the Dental Board did not qualify for the state action defense was not a decision on the merits. Whether the Board's conduct violated the antitrust laws was an issue for trial before an Administrative Law Judge. After a month-long hearing, an ALJ concluded that the Board's conduct violated Section 5 of the FTC Act. The ALJ, in a 122 page decision, found that the Board's conduct had harmed competition and that the Board had failed to advance a legitimate procompetitive justification for its conduct. The Board appealed the ALJ's decision to the full Commission, which affirmed.[45]

In February of this year, the Dental Board appealed the Commission's decision to the Fourth Circuit.[46] The appeal has been fully briefed but oral argument has not yet been scheduled. Although there are a variety of issues on appeal, in my view, the court's decision is

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[43] *Id.* at 16. The Commission Opinion stated that "we have assumed, but not decided, that the Board has satisfied the clear articulation requirement." *See id.* at 7 n.8.

[44] *Id.* at 16 (quoting *Patrick*, 486 U.S. at 101).

[45] Opinion of the Commission, North Carolina Board of Dental Examiners, Docket No. 9343 (Dec. 7, 2011), *available at* http://www.ftc.gov/os/adjpro/d9343/111207ncdentalopinion.pdf (decision on liability).

[46] The case on appeal is North Carolina State Board of Dental Examiners v. FTC, No. 12-1172 (4th Cir.)

likely to turn on whether the court agrees with the Commission that a state regulatory body controlled by market participants must satisfy both prongs of *Midcal* to be entitled to state action immunity. A number of amicus briefs have been submitted to the court, including from other state licensing boards.

The third and most important recent FTC state action case is *Phoebe Putney*. In 2011, the FTC and the Attorney General of the State of Georgia challenged Phoebe Putney Health System's agreement to acquire Palmyra Park Hospital. For all practical purposes, the transaction was a merger to monopoly because Phoebe and Palmyra operated the only two significant hospitals in the Albany, Georgia area.[47]

According to the FTC's complaint, Phoebe had structured the deal in a way that used the local Hospital Authority in an attempt to shield the acquisition from federal antitrust scrutiny under the state action doctrine. Specifically, Phoebe developed a plan under which the Hospital Authority would acquire Palmyra and then lease it to a corporation controlled by Phoebe. The Hospital Authority is an arm of the State of Georgia and already held title to, but did not operate or actively supervise, Phoebe's hospital.

The FTC alleged that notwithstanding the Hospital Authority's nominal involvement in the transaction, the state action doctrine did not apply. The transaction was conceived, structured, financed, and guaranteed by Phoebe, for its private pecuniary interest, with the ultimate purpose of gaining full economic and operational control over Palmyra. The Hospital Authority's role, according to the FTC's complaint, was that of a "strawman." The FTC argued that the transaction was presented to the Hospital Authority at the eleventh hour and that the

[47] Specifically, the FTC's complaint alleged that the transaction would eliminate competition between Phoebe and Palmyra in the market for inpatient general acute-care hospital services sold to commercial health plans in Albany and the surrounding six-county area. Palmyra Medical Center is now known as Phoebe North.

Hospital Authority did not engage in any independent analysis or supervision of the proposed acquisition.

The FTC filed an administrative complaint challenging the transaction. In addition, it sought a preliminary injunction blocking consummation of the transaction in the U.S. District Court for the Middle District of Georgia.

The respondents filed separate motions to dismiss or, alternatively, for summary judgment. Their primary argument was that the proposed transaction was immunized from the federal antitrust laws by operation of the state action doctrine. The district court granted the motions to dismiss, holding that anticompetitive acquisitions and leases by the Hospital Authority were reasonably foreseeable under the Georgia Hospital Authorities Law.[48] The court then proceeded to find that Phoebe qualified for the state action defense because – contrary to numerous complaint allegations – the Hospital Authority directed the transaction and because Phoebe was "an agent of the Authority."[49] Perhaps the only positive aspect of the district court's decision was its recognition that Section 7 of the Clayton Act applied not only to the Hospital Authority's acquisition of Palmyra, but also the Authority's planned lease to Phoebe.

The FTC appealed to the Eleventh Circuit, arguing that because of Phoebe's role in the transaction, both prongs of *Midcal* applied. In addition, there was no clear articulation of state policy to displace competition and no active supervision by the state itself.

In December of last year, the Eleventh Circuit affirmed the district court's dismissal of the FTC's complaint.[50] The court "agree[d] with the Commission that, on the facts alleged, the joint operation of [Phoebe] and Palmyra would substantially lessen competition or tend to create,

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[48] *FTC v. Phoebe Putney Health Sys., Inc.*, 793 F. Supp. 2d 1356 (M.D. Ga. 2011).

[49] *Id*. at 1380 (quotations omitted).

[50] *FTC v. Phoebe Putney Health Sys., Inc.*, 663 F.3d 1369 (11th Cir. 2011).

if not create, a monopoly."[51] The court concluded, however, that the state action doctrine exempted the transaction from antitrust scrutiny because "anticompetitive consequences were a foreseeable result of the statute authorizing the Authority's conduct."[52] The court stated that in the Eleventh Circuit, the clear articulation requirement can be satisfied with a showing that the anticompetitive conduct is a "'foreseeable result' of the legislation" and explained that "a 'foreseeable anticompetitive effect' need not be 'one that ordinarily occurs, routinely occurs, or is inherently likely to occur as a result of the empowering legislation."[53] The court reasoned that

but it also potentially exempted a wide swath of the economy from the federal antitrust laws. Bear in mind that there are tens of thousands of political subdivisions in the country to which the court of appeals' corporate powers logic could apply. It would not take clever antitrust lawyers long to find ways to exempt a variety of other hospital and non-hospital acquisitions and other business activity from the antitrust laws through some nominal involvement or approval of these entities.

In part for this reason, the FTC, joined by the Solicitor General, filed a petition for writ of certiorari from the Supreme Court, which – I'm pleased to say – granted the petition.[56]

In its opening brief on the merits,[57] the FTC argued that the Eleventh Circuit's interpretation of the clear articulation test, which involves examining whether the anticompetitive conduct was "foreseeable," is inconsistent with Supreme Court precedent. The Supreme Court's decisions make clear that a broad, neutral conferral of powers that can be exercised in either procompetitive or anticompetitive ways do not provide a "clear articulation" of a state policy to displace competition. Rather, the displacement of competition must be the "inherent" or "necessary" result of the state's regulations. As the Supreme Court said in its *Boulder* decision: "A State that allows its municipalities to do as they please can hardly be said to have 'contemplated' the specific anticompetitive actions for which municipal liability is sought."[58]

Under the correct standard, Georgia's Hospital Authorities Law does not clearly articulate a state policy to displace competition in the provision of hospital services. The law

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[56] The case is *FTC v. Phoebe Putney Health System, Inc.*, No. 11-1160 (U.S.).

[57] Brief for the Petitioner, FTC v. Phoebe Putney Health System, Inc., No. 11-1160 (U.S. Aug. 2012), *available at* http://www.ftc.gov/os/caselist/1110067/120820phoebeputneybrief.pdf. The following summary of the FTC's arguments includes excerpts from the FTC's brief.

[58] *Community Commc'ns Co. v. City of Boulder*, 455 U.S. 40, 55 (1982).

mere possibility that the Authority might someday play a more active role in overseeing [Phoebe] is no reason to regard the transaction at issue here as anything but an unsupervised private merger to monopoly."[61]

Oral argument before the Court will take place on November 26, and a decision is likely in the Spring.

Conclusion

As I mentioned at the outset of my remarks, antitrust enforcement is one of the few areas where the federal courts have been curtailing the reach of federal power out of a claimed deference to state sovereignty. I have no objection to circumscribing the federal antitrust laws to take legitimate federalism concerns into consideration. However, when courts apply the state action doctrine with little or no evidence that the state intended to restrain competition, national