THE FTC AND STATE ACTION: EVOLVING VIEWS ON THE PROPER ROLE OF GOVERNMENT

John T. Delacourt
Todd J. Zywicki*

The 90th Anniversary of the Federal Trade Commission provides a welcome opportunity to re-assess the Commission's interactions with other governmental entities. These interactions often have been shaped by key limitations on the agency's jurisdiction, such as the state action doctrine of *Parker v. Brown*.[1]

The state action doctrine was born in an era of exceptional confidence in government, with governmental entities widely regarded as unbiased and conscientious defenders of the public interest. Over time, however, more cautious and skeptical theories of government began to gain sway. In particular, the school of thought known as "public choice"—which holds that governmental entities, like private firms, will act in their economic self-interest—began to influence both legal theory and competition policy. Indeed, a close examination of recent state action case law suggests that public choice thinking has driven a slow, but consistent, evolution of the doctrine toward *less* deference to state regulators and more careful assessment of the actual incentives that drive their decision making. This evolution in thinking, however, has not been accompanied by the development of a systematic, analytical framework to guide the application of the state action doctrine in particular cases. Developing such a framework should therefore remain a top priority of leading antitrust policymakers, including those at the Federal Trade Commission.

---

* John T. Delacourt is Chief Antitrust Counsel in the FTC's Office of Policy Planning. Todd J. Zywicki is a Professor of Law at George Mason University School of Law and former Director of the FTC's Office of Policy Planning. The views expressed herein are those of the authors and do not necessarily reflect the views of the Federal Trade Commission.

[1] 317 U.S. 341 (1943).

I. ORIGINS OF THE STATE ACTION DOCTRINE

A. THE *PARKER* DECISION

The state action doctrine was first articulated by the Supreme Court in the 1943 case of *Parker v. Brown*.[2] The *Parker* case arose out of a lone raisin producer's efforts to enjoin enforcement of a mandatory state program controlling the marketing, sale, and, therefore, the price of certain agricultural products. Among other allegations, plaintiff Brown asserted that the State of California had violated the Sherman Act by passing and enforcing the Agricultural Prorate Act.[3] Although the Court acknowledged that the objective and mechanics of the Act's scheme had the potential to be anticompetitive, Chief Justice Stone characterized the scheme as benevolent, apolitical industrial planning designed to protect raisin producers from the pernicious forces of the market process.[4]

Brown claimed that, prior to adoption of the Act, he had entered into contracts for the sale of his 1940 raisin crop. Consequently, unless the Act's compulsory marketing scheme was enjoined, it would be enforced against him, possibly through criminal prosecution. Although the Court acknowledged that the scheme likely would have constituted a Sherman Act violation if it had been implemented though a contract, combination, or conspiracy among private parties,[5] it refused to adopt the same reasoning in the context of action by a state. As the Court explained, the California agricultural marketing program at issue "derived its authority and its efficacy from the legislative command of the state and was not intended to operate or become effective without that command."[6] Accordingly, the program was exempted from federal antitrust enforcement, as "[t]he Sherman Act makes no mention of the state as such, and gives no hint that it was intended to restrain state action or official action directed by a state."[7]

---

[2] *Id.*

[3] *Id.* at 348–49.

[4] According to the Court:

> [T]he declared objective of the California Act is to prevent excessive supplies of agricultural commodities from "adversely affecting" the market, and although the statute speaks in terms of "economic stability" and "agricultural waste" rather than of price, the evident purpose and effect of the regulation is to "conserve the agricultural wealth of the State" by raising and maintaining prices, but "without permitting unreasonable profits to the producers."

Id. at 355.

[5] *Id.* at 350–51.

[6] *Id.* at 350.

[7] *Id.* at 351.

B. Historical Context

While the *Parker* Court's apparent willingness to accept any and all government involvement in the marketplace as an unqualified good may seem quite surprising to the 21st century reader, it is substantially less so when one accounts for historical context. The *Parker* case was adjudicated and decided in the early 1940s, in the midst of World War II, when the economic privations of the Great Depression were still a fresh memory. Thus, California's Agricultural Prorate Act would have been viewed not as a protectionist anachronism, but as cutting edge industrial policy.

Though certainly not a complete explanation, even this thumbnail historical sketch gives a strong indication of the source of the "public interest" mindset that so deeply infuses the Supreme Court's *Parker* decision. This mindset is extremely skeptical of markets, favoring instead government industrial policy as a necessary means of protecting the public from the perceived chaos of unfettered competition. A generation of economists and political theorists, from at least the beginnings of the New Deal to the 1970s, largely relied on this public interest theory to explain government intervention in the market process.[8] Tracing its roots back to the deliberative "republican" theory of government,[9] this pro-government and relatively deferential political theory essentially posits that "regulation is supplied in response to the demand of the public for the correction of inefficient or inequitable market practices."[10]

C. Roots in Public Interest Theory

The public interest theory underlying the *Parker* decision manifests itself in a number of ways, most notably in the Court's label-oriented and deferential approach to state action analysis. The Court's approach is "label-oriented" in the sense that it focuses unduly on titles—such as "official," "public," or "governmental"—as a kind of shortcut analysis, rather than evaluating each defendant's incentives to purse its own

---

[8] *See generally* Richard A. Posner, *Theories of Economic Regulation*, 5 Bell J. Econ. & Mgmt. Sci. 335 (1974) (examining and comparing basis of public interest theory with other theories of economic regulation).

[9] The proponent of a "republican" theory of government expects—or at least hopes—that citizens will subordinate their private interests to a separate common good through an enlightened, civic-minded, deliberative process. This view is perhaps best expressed in Thomas Jefferson's aspiration: "Enlighten the people generally, and tyranny and oppression of body and mind will vanish like evil spirits at the dawn of day." 14 The Writings of Thomas Jefferson 491 (A. Lipscomb & A. Berghs eds., 1903). *See also* Cass. R. Sunstein, *Interest Groups in American Public Law*, 38 Stan. L. Rev. 29, 31–32 (1985) (describing original conception of "republican" view of politics).

[10] Posner, *supra* note 8, at 335.

agenda at the expense of the state's. Likewise, the Court's approach is "deferential" in the sense that it is willing to give governmental actors the benefit of the doubt without first putting them to their proof. Both tendencies are illustrated by important aspects of the Court's decision.

First, the *Parker* opinion places fairly weak emphasis on the federalism rationale for the decision. Although the Court notes that the state action exemption is rooted in federalism, and that it will not lightly impute to Congress "an unexpressed purpose to nullify a state's control over its officers and agents,"[11] the Court's language is less precise in other portions of the opinion. Although it is clear, when the opinion is taken as a whole, that the Court intended to limit the *Parker* exemption to one specific category of governmental actors—states—at various points the Court uses looser language, such as references to "official action," "act[s] of government," and "the state *or its municipalities,*"[12] which suggests that the exemption may be broader. Though seemingly insignificant, the Court's use of these imprecise labels as shorthand has led to confusion in a least some lower courts, where efforts to extend the state action exemption to all "public" or "governmental" entities occasionally have gained traction.[13]

Second, the opinion reflects complete indifference to the issue of electoral accountability. The Court openly acknowledges that the California marketing scheme at issue encompasses "almost all of the raisins consumed in the United States, and nearly one-half of the world crop,"[14] yet it continues to analyze the matter as purely one of *state* policy. Despite the fact that the vast majority of the affected raisins—90–95 percent—would be consumed outside the State of California, by consumers with no access to the California ballot box, the Court makes no mention of a potential externalities problem.[15] Faith in "good government," it seems, easily overcame the concerns that typically arise where a small, tightly concentrated group of producers is positioned to impose substantial price increases on a diffuse, unorganized group of consumers.

Third, the opinion reflects substantial deference to state oversight efforts. For example, the Court states, without further elaboration, that

---

[11] *Parker*, 317 U.S. at 351.

[12] *Id.* at 351–52 (emphasis added).

[13] *See infra* Part III.A.

[14] *Parker*, 317 U.S. at 345.

[15] A number of commentators have raised concerns regarding the significant competitive harm that may result from substantial interstate spillovers. *See, e.g.*, Frank H. Easterbrook, *Antitrust and the Economics of Federalism*, 26 J.L. & ECON. 23 (1983); Timothy J. Brennan, *Local Government Action and Antitrust Policy: An Economic Analysis*, 12 FORDHAM URB. L.J. 405 (1984); JIM ROSSI, POLITICAL BARGAINING AND JUDICIAL INTERVENTION IN CONSTITU-

consumers are protected by a portion of the legislation authorizing the Agricultural Prorate Advisory Commission to reject a petition for establishment of a collective marketing plan if it would "permit[] unreasonable profits to producers . . . ."[16] The Court does not address how "unreasonable profits" would be defined or how the Commission would go about auditing producer profits in the first place. Furthermore, the Court does not address the more critical issue of the composition of the Commission, beyond a brief description of the number of members. Presumably, as in many other professional contexts, these sectoral regulators would be drawn largely from the ranks of the industry itself.

Finally, the *Parker* opinion reflects substantial deference to purported state objectives. As in the case of the Court's deference to state oversight efforts, its deference to purported state objectives is revealed less by what the decision said than what it did not say. Although the objective of the Prorate Act was, quite plainly, to raise agricultural prices through the cartelization of California producers, the sponsors of the legislation, understandably, elected to describe its goals more diplomatically. Thus, the *Parker* Court notes, without further elaboration, that "[t]he declared purpose of the Act is to 'conserve the agricultural wealth of the State' and to 'prevent economic waste in the marketing of agricultural crops' of the state."[17] While the Court's failure to address squarely the likely consumer impact of the legislation, as well as the outright deceptiveness of the "economic waste" language, can perhaps be chalked up to genuine New Deal enthusiasm, it also reflects the *Parker* opinion's deep roots in public interest theory, including that theory's general enthusiasm for government solutions.

II. EVOLVING THEORETICAL UNDERPINNINGS: FROM PUBLIC INTEREST TO PUBLIC CHOICE

A. The Rise of Public Choice Theory

Although public interest theory survives in a variety of forms, and continues to claim adherents, much has changed since the time of *Parker*. For better or worse, skepticism regarding the role of government has grown increasingly common and now plays a more dominant role in economic and political theory. While initial challenges to public interest theory emerged much earlier,[18] a consensus counterpoint began to take

---

tional and Antitrust Federalism 46–58 (Fla. St. U. C. L. Public Law and Legal Theory Working Paper No. 147, 2005).

[16] *Id.* at 346.

[17] *Id.*

[18] *See* E.E. Schattschneider, Politics, Pressures and the Tariff (1935) (concluding that interest groups pursuing their own economic self-interest helped shape the Smoot-

hold during the 1960s.[19] Leading adherents of this alternative viewpoint included Milton Friedman who, in his 1962 work *Capitalism & Freedom*, argued that "[t]he pressure [for the imposition of occupational licensing standards] invariably comes from members of the occupation itself" and not necessarily from an aggrieved public.[20] Other notable adherents included James Buchanan and Gordon Tullock, who, in the same year, published *The Calculus of Consent*,[21] in which they analyzed political decision making using the economic principles of rational self-interest and exchange. The result was "a substantive criticism of the then-dominant elevation of majority voting to sacrosanct status in political science."[22]

The response to public interest theory continued with Tullock's 1967 paper *The Welfare Costs of Tariffs, Monopolies and Theft*,[23] which introduced the concept that would later come to be known as "rent seeking."[24] Tullock argued that where private parties can use political action to extract wealth—which he termed economic "rents"—from other private parties, they will expend the resources necessary to obtain that value.[25] If the wealth gain takes the form of a transfer from one group to another, the investment expended by the rent seeker represents economic waste and results in a reduction of aggregate wealth. Subsequent application of the rent-seeking rubric suggested, at least to some commentators, that "much of modern politics can only be interpreted as rent-seeking activity."[26]

Hawley Tariff of 1930); EARL LATHAM, THE GROUP BASIS OF POLITICS (1952) (outlining a pluralistic interpretation of politics).

[19] *See* Daniel A. Farber & Philip P. Frickey, *The Jurisprudence of Public Choice*, 65 TEX. L. REV. 873, 890–91 (1987) (examining changing perceptions of the economic theory of legislation and noting that "[u]ntil about twenty years ago, economists somewhat naively assumed that politicians were interested solely in furthering the public interest.").

[20] MILTON FRIEDMAN, CAPITALISM & FREEDOM 140 (1962). Similar concerns regarding financial self-interest have also been expressed in recent state action scholarship. *See* Einer R. Elhauge, *The Scope of Antitrust Process*, 104 HARV. L. REV. 667 (1991) (contrasting the decisions of disinterested, politically accountable actors—which *should* be exempted from antitrust scrutiny—with the decisions of financially interested, unaccountable actors—which should not).

[21] JAMES M. BUCHANAN & GORDON TULLOCK, THE CALCULUS OF CONSENT: LOGICAL FOUNDATIONS OF CONSTITUTIONAL DEMOCRACY (1962).

[22] JAMES M. BUCHANAN, PUBLIC CHOICE: THE ORIGINS AND DEVELOPMENT OF A RESEARCH PROGRAM 5 (2003), *available at* http://www.gmu.edu/centers/publicchoice/Booklet.pdf [hereinafter PUBLIC CHOICE: ORIGINS AND DEVELOPMENT].

[23] Gordon Tullock, *The Welfare Costs of Tariffs, Monopolies, and Theft*, 5 W. ECON. J. 224 (1967).

[24] *See* Anne O. Kreuger, *The Political Economy of the Rent-Seeking Society*, 64 AM. ECON. REV. 291 (1974) (coining the term "rent seeking").

[25] PUBLIC CHOICE: ORIGINS AND DEVELOPMENT, *supra* note 22, at 6.

[26] *Id.* at 7.

The work begun in the 1960s continued, with a renewed focus on the ever expanding regulatory state. In his 1971 article *The Theory of Economic Regulation*,[27] for example, George Stigler described how small, well-organized interest groups often use the political process to "capture" regulatory schemes and turn them to their own advantage.[28] Building on this insight, Richard Posner's 1974 article *Theories of Economic Regulation*[29] argued that the public interest theory of regulation was outmoded, and called for more empirical research into "interest group" or "capture" theories.

These early works formed the framework for the alternative viewpoint that has come to be known as "public choice" theory. Unlike public interest theory, which traces its roots back to the republican theory of government, public choice theory finds its origins in the slightly more cynical "pluralist" theory of government.[30] Recalling James Madison's famous warning against factions in *Federalist No. 10*,[31] public choice theory has now developed into a mature and widely accepted mode of analysis, the core principles of which can be summarized in three words: "politics without romance."[32]

B. Pulling up Roots: A New Basis for *Parker*

The emergence of public choice theory, and its increasing acceptance by judges,[33] also has been reflected in the Supreme Court's thinking on

---

[27] George J. Stigler, *The Theory of Economic Regulation*, 2 BELL J. ECON & MGMT. SCI. 3 (1971).

[28] The public choice theory notion of regulatory capture also has played an important role in state action scholarship. *See* John S. Wiley, Jr., *A Capture Theory of Antitrust Federalism*, 99 HARV. L. REV. 713 (1986) (arguing that an anticompetitive restraint imposed by a state government should be preempted only if it: (1) arises from producer "capture," (2) does not address a substantial market inefficiency, and (3) is not covered by an antitrust exemption). *But see* David McGowan & Mark A. Lemley, *Antitrust Immunity: State Action and Federalism, Petitioning and the First Amendment*, HARV. J. L. & PUB. POL'Y 293 (1994) (rejecting Wiley's approach as unduly deferential to state action, given that such action is a potentially significant source of consumer harm).

[29] Posner, *supra* note 8.

[30] The proponent of a "pluralist" theory of government expects that self-interested groups will bargain vigorously with each other to further their own ends. The result of this legislative bargaining, whatever it may be, represents the so-called common good. *See* Sunstein, *supra* note 9, at 32–34.

[31] THE FEDERALIST No. 10 (James Madison) (Clinton Rossiter ed., 1961). In warning of the dangers of factions, Madison specified that, "[b]y a faction, I understand a number of citizens, whether amounting to a majority or a minority of the whole, who are united and actuated by some common impulse of passion, or of interest, adverse to the rights of other citizens, or to the permanent and aggregate interests of the community." *Id.* at 78.

[32] PUBLIC CHOICE: ORIGINS AND DEVELOPMENT, *supra* note 22, at 8.

[33] *See, e.g.*, Riley v. St. Luke's Episcopal Hosp., 252 F.3d 749, 762 n.16 (5th Cir. 2001) (en banc) (Smith and Demoss, JJ., dissenting) (noting that "[p]ublic choice theory tells

antitrust exemptions. Beginning in the 1970s, the Court's reliance on public interest theory began to give way to a more incentive-oriented and skeptical approach to state action analysis. The approach is "incentive-oriented" in the sense that it presumes that even governmental entities will tend to act in an economically self-interested manner and tries to determine whether that parochial self-interest coincides or conflicts with the interests of the state. Likewise, the approach is "skeptical" in the sense that it grants no greater deference to a governmental entity than to a profit-seeking private firm. Both tendencies, which reflect a decidedly more cynical view of government, are illustrated by a series of state action decisions that mark a steady rejection of the key aspects of the *Parker* decision that root it so firmly in the public interest tradition.

1. City of Lafayette—*A Renewed Focus on Federalism*

The Supreme Court's 1978 opinion in *City of Lafayette v. Louisiana Power & Light Co.* marks an early move in this direction.[34] The objectionable restraint at issue was the tying of electric utility service to the purchase of monopoly gas and water service. The private utility, Louisiana Power & Light, argued that the City of Lafayette had prevented it from competing by requiring certain customers to purchase electricity from the City as a precondition of continued gas and water service. In response, the City asserted that its actions were shielded by the state action doctrine, arguing that "since a city is merely a subdivision of a state and only exercises power delegated to it by the state, *Parker*'s findings regarding the congressionally intended scope of the Sherman Act apply with equal force to such political subdivisions."[35] The Court rejected this argument, holding that a municipality's status as a subdivision of a state does not cloak all of the municipality's activities in state action protection.[36]

Breaking with the *Parker* opinion, the *City of Lafayette* opinion places a significantly stronger emphasis on the federalism rationale for the decision. Rather than leaving the door open to a broader exemption, available to "public" and "governmental" entities generally, the Court

---

us that . . . [where] the public is for the most part unaware of [a] settlement—while the interest group lobbies to join the settlement—[that] gives the government a one-sided incentive to go along with whatever agreement the private parties have made"); NLRB v. Fluor Daniel, Inc., 161 F.3d 953, 963 (6th Cir. 1998) (noting that defendant, "[i]n the terminology of public choice economics . . . alleges that the NLRB has been captured by organized labor interests"); Dickson v. Secretary of Defense, 68 F.3d 1396, 1407 (D.C. Cir. 1995) (Silberman, J., concurring in part and dissenting in part) (arguing that "public choice economists would surely point out that [a] presumption [that Congress intends judicial review of agency action] is more than a little self-serving").

[34] 435 U.S. 389 (1978).

[35] *Id.* at 394.

[36] *Id.* at 411–13.

makes it clear that a federal system recognizes only two sovereigns—federal and state. A municipality, in contrast, enjoys no special status, as "[c]ities are not themselves sovereign" and "they do not receive all the federal deference of the States that create them."[37] The Court further explains that the reason for this distinction is that municipalities have their *own* interests, which are separate and distinct from those of the state. A municipality's status as a "public" entity does not alter this reality, as "the economic choices made by public corporations in the conduct of their business affairs, *designed as they are to assure maximum benefits for the community constituency*, are not inherently more likely to comport with the broader interests of national economic well-being than are those of private corporations . . . ."[38]

2. Town of Hallie—*The Importance of Electoral Accountability*

In the mid-1980s the Court was once again called upon to evaluate the state action status of municipal conduct and, once again, adopted a more public choice-oriented approach. Like the *City of Lafayette* case, *Town of Hallie v. City of Eau Claire*[39] involved a municipal tying arrangement. By this time, however, much of the Court's state action jurisprudence was dedicated to refining the two-prong test articulated in *California Retail Liquor Dealers Association v. Midcal Aluminum, Inc.*[40] Under *Midcal*, a private firm or a subordinate governmental body acting pursuant to a delegation of state authority is entitled to state action protection, provided that its conduct is: (1) in conformity with a "clearly articulated" state policy, and (2) "actively supervised" by the state.[41]

Plaintiffs—a group of unincorporated Wisconsin townships adjacent to the City of Eau Claire—alleged Sherman Act violations arising from the City's practice of tying the provision of sewage collection and transportation service to the purchase of its monopoly sewage treatment service. The City moved to dismiss the case on state action grounds, but plaintiffs challenged its ability to satisfy either prong of the *Midcal* test. First, plaintiffs asserted that the "clear articulation" prong of the *Midcal* test required the City to demonstrate that its actions were "compelled" by a state policy. The Court rejected this approach, holding instead that the "clear articulation" requirement is satisfied when the anticompetitive conduct at issue is a mere "foreseeable result" of a state policy.[42] Plaintiffs

[37] *Id.* at 411.

[38] *Id.* at 403 (emphasis added).

[39] 471 U.S. 34 (1985).

[40] 445 U.S. 97 (1980).

[41] *Id.* at 105.

[42] *Town of Hallie*, 471 U.S. at 41–42.

next asserted that the City's conduct had not been actively supervised by the state. The Court rejected this contention as well, holding instead that the "active supervision" requirement should "not be imposed in cases in which the actor is a municipality."[43]

At first glance, the *Town of Hallie* decision appears to be a step backwards, with the Court moving away from a public choice approach towards the more familiar terrain of public interest theory. This impression is shaped, in large part, by the Court's discussion of the "clear articulation" prong, which notes that municipal conduct need not be "compelled" by a state policy because "[w]e may presume, absent a showing to the contrary, that [a] municipality acts in the public interest."[44] However, this statement is modified by crucial language that, in sharp contrast to *Parker*, emphasizes the importance of electoral accountability. Specifically, the Court explains that the reason municipalities can be presumed to act in the public interest is their conduct is "likely to be exposed to public scrutiny" and "checked . . . through the electoral process."[45] Thus, the *Town of Hallie* "foreseeability" standard for clear articulation is grounded not in an abiding faith in "good government," but in a realistic assessment of the incentives that govern municipal decision making. Indeed, application of this standard to the conduct at issue in the *Parker* case may have yielded a different result, as it was clear there that the electoral process would not function as an effective "check," given that 90–95 percent of the affected raisin consumers lived outside the state.

3. Ticor—*Skepticism of State Oversight*

In the 1990s the trend toward a public choice approach to state action analysis continued. In *Federal Trade Commission v. Ticor Title Insurance Co.*[46] the Supreme Court addressed the issue of whether *Midcal*'s "active supervision" requirement could be satisfied by a so-called "negative option" system of oversight. The *Ticor* case arose out of allegations that six of the nation's largest title insurance companies had conspired to fix prices on title searches and title examinations. The FTC alleged that the defendants had acted through rating bureaus—private entities organized by the title companies for the purpose of establishing uniform rates for their members.[47] In response, defendants argued that the conduct of the rating bureaus was in conformity with a clearly articulated

[43] *Id.* at 46.

[44] *Id.* at 45.

[45] *Id.* at 45 n.9.

[46] 504 U.S. 621 (1992).

[47] *Id.* at 629.

state policy. While the FTC did not contest this first prong of the *Midcal* test, it vigorously contested the issue of active supervision. The Commission asserted that a "negative option" system—pursuant to which privately set rates become "official" if the state declines to take any action within a specified period of time[48]—is not sufficiently "active" to satisfy *Midcal*'s second prong. The Court agreed.[49]

In reaching this conclusion, the Court appeared to reject yet another key aspect of the *Parker* Court's reasoning. While the *Parker* Court seemed content to defer to most—indeed, almost all—state oversight efforts, the *Ticor* Court was substantially more skeptical. By rejecting the "negative option" system, the Court made clear that a state's good intentions alone do not satisfy the active supervision requirement. As the Court explained: "The *mere potential* for state supervision is not an adequate substitute for a decision by the State."[50] In contrast, by accepting at face value the Agricultural Prorate Commission's vague and standardless commitment to prevent "unreasonable profits for producers," the *Parker* Court appeared to embrace good intentions and "mere potential" as the order of the day. The *Ticor* Court observed that state action protection is "conferred out of respect for ongoing regulation by the State, not out of respect for the economics of price restraint."[51] It thereby acknowledged not only the possibility that state oversight efforts could be inadequate, but that this inadequacy might reflect an improper motive (i.e., the desire to pursue "price restraint" for a nonregulatory purpose). Whether one regards the Court as being cynical or realistic in its approach, the bloom was clearly off the public interest rose.

4. Freedom Holdings—*Skepticism of State Objectives*

Although the Supreme Court has not yet had an opportunity to revisit the state action doctrine in the present decade, there have been significant developments at the court of appeals level that reflect the continuing trend toward a public choice-oriented approach. Chief among these developments is the Second Circuit's recent decision in *Freedom Holdings Inc. v. Spitzer*.[52] It is perhaps fitting that this latest step in the move

---

[48] *Id.*

[49] *Id.* at 637–38.

[50] *Id.* at 638 (emphasis added).

[51] *Id.* at 633.

[52] 357 F.3d 205 (2d Cir. 2004) (*Freedom Holdings I*); 363 F.3d 149 (2d Cir. 2004) (*Freedom Holdings II*) (collectively *Freedom Holdings*). Notably, the *Freedom Holdings* opinion is the result of two, separate published opinions by the court. The second opinion was in response to a petition for rehearing filed by the State of New York, and, while the court denied the petition, it issued a supplemental opinion because of the "importance of this litigation." 363 F.3d at 151.

toward "politics without romance" arises in the context of state efforts to implement the tobacco Master Settlement Agreement (MSA)—a process that has made cynics of even the most resolute good government advocates. Plaintiff cigarette importers argued that New York's Contraband Act functioned to implement an output cartel and, therefore, was preempted by Section 1 of the Sherman Act.[53] The Second Circuit ultimately agreed[54] and, in the course of rendering its decision, offered a groundbreaking clarification of *Midcal*'s first prong. Specifically, the court held that in order to satisfy the "clear articulation" requirement: (1) a defendant must "act in furtherance of *legitimate* state policy goals," and (2) its conduct must "have a *plausible nexus* to those goals."[55]

As both prongs of this test suggest, the *Freedom Holdings* opinion marks a sharp departure from the *Parker* Court's willingness to defer to almost any purported state objective. In contrast to the *Parker* Court's unquestioning acceptance of California's euphemistic objective of preventing economic waste, the *Freedom Holdings* opinion reflects a far more searching inquiry. When evaluating the potential objectives of New York's Contraband Act, the court considered two possibilities. First, that the state intended to share in the tobacco cartel's monopoly rents. This objective, however, raised serious questions of legitimacy, spurring the court to observe, without deciding, that "it is questionable whether *Parker* immunity extends to a cartel arrangement supported by a state solely to allow the state to share the monopoly profits as state revenue."[56] A second possibility was that the state intended to protect the public health, by discouraging smoking and compelling cigarette manufacturers to bear the cost of smoking-related illnesses. While this objective satisfied the legitimacy prong, the court ultimately concluded that it simply could not pass the "plausible nexus" test.[57] Despite multiple attempts, the defen-

---

[53] *Freedom Holdings I*, 357 F.3d at 211.

[54] In contrast, the Northern District of California recently reached the opposite conclusion when presented with nearly identical facts. *See* Sanders v. Lockyer, No. C 04-02281 SI, 2005 WL 756576 (N.D. Cal. Mar. 28, 2005). The court expressly declined to follow *Freedom Holdings*, holding instead that, because California's enactment of legislation implementing the MSA was an act of the state as sovereign, *Midcal* did not apply. *Id.* at *5, *9. The court was not persuaded by the argument that the state had delegated independent pricing authority to the defendant tobacco companies. *Id.*

[55] *Freedom Holdings II*, 363 F.3d at 156 (emphasis added).

[56] *Freedom Holdings I*, 357 F.3d at 229.

[57] *Freedom Holdings II*, 363 F.3d at 156. Perhaps the most telling measure of the degree of the court's skepticism regarding defendants' purported public health objectives is the hypothetical it used to illustrate the "plausible nexus" test. The court explained that, "[f]or example, a court facing an antitrust challenge to a state statute allowing price-fixing by car washes is not obliged to dismiss the complaint because the state asserts that the law will improve the performance of the state capital city's symphony orchestra." *Id.* The court found New York's purported anti-smoking rationale equally fanciful.

dants were never able to provide a *plausible* reason—a fairly low threshold—why their purported public health objectives could only be accomplished through the Contraband Act's market-sharing scheme, as opposed to other, less anticompetitive, alternatives.[58] The court was careful to note that these clarifications of the "clear articulation" requirement are merely intended to weed out pretextual state objectives, not to permit courts to "second guess" the policy judgments of states.[59] Nevertheless, one cannot help but wonder whether the Agricultural Prorate Act at issue in *Parker* would have survived even so broad a screen.

III. A STATIC ANALYTICAL FRAMEWORK

A. Confusion in the Lower Courts

Although the philosophical underpinnings of the *Parker* doctrine have evolved substantially over time, the same cannot be said of the analytical framework for state action analysis. While the move from a public interest approach to a public choice approach has been relatively consistent and sustained, beginning in *City of Lafayette* and culminating in the Second Circuit's *Freedom Holdings* opinion, the lack of corresponding modifications to the analytical framework often has prevented this message from being transmitted to the lower courts. Thus, many courts continue to apply the *Midcal* factors in a manner that reflects *Parker*'s public interest theory roots, rather than the state action doctrine's contemporary moorings in public choice theory.

In response to these concerns, the FTC recently convened a task force of Commission staff to re-examine the state action doctrine and evaluate the sufficiency of the current analytical framework. Among other findings, the Task Force Report noted that certain lower court interpretations of the "clear articulation" requirement continue to reflect substantial deference to governmental actors.[60] This tendency is demonstrated by the willingness of some courts to infer a state policy of displacing competition from a legislative grant of general corporate powers.[61] In addition to mission-specific powers, states will often empower subsidiary regulatory authorities to enter into contracts, make acquisitions, and enter into joint ventures. Although it is clear that parties exercising such basic

[58] *Id.* at 156.

[59] *Id.* at 157.

[60] *See* Office of Policy Planning, Federal Trade Commission, Report of the State Action Task Force 25–36 (Sept. 2003) [hereinafter FTC State Action Report], *available at* http://www.ftc.gov/os/2003/09/stateactionreport.pdf; *see also* John E. Lopatka & William H. Page, *State Action and the Meaning of Agreement Under the Sherman Act: An Approach to Hybrid Restraints*, 20 Yale J. on Reg. 269 (2003).

[61] *See* FTC State Action Report, *supra* note 60, at 26–29.

powers are accorded no special antitrust treatment in the private sector, some courts have inferred from them a state policy to restrain competition. Thus, certain courts have held *exclusive* contracts to be a foreseeable result of a general power to contract[62] and exclusion of competitors to be a foreseeable result of a general power to make acquisitions.[63]

The Report also notes that certain lower court interpretations of the "active supervision" requirement continue to be unduly label-oriented. This tendency is particularly pronounced with respect to efforts to determine which entities should be subject to the requirement. Rather than engaging in a careful analysis of the entity's political and economic incentives—and whether those incentives tend to conform with, or diverge from, state policy—some lower courts simply have looked for indicia that an entity is "public" or "governmental" in nature.[64] A pair of Eleventh Circuit cases is illustrative of this point. In the first, the court attempted to determine whether a hospital authority should be subjected to active supervision by evaluating such criteria as the right to use eminent domain, receive proceeds from the sale of general obligations or county bonds, and issue revenue anticipation certificates or other evidence of indebtedness.[65] In the second, involving the active supervision status of an association of residential property insurers, the court relied on an equally dubious laundry list of factors, including "open records, tax exemption, exercise of governmental function, [and] lack of possibility of private profit."[66] Both cases demonstrate how placing the focus on a entity's "public" status—presumably as assurance of its dedication to the public interest—can distract a court from pursuing the state action

[62] *See* Martin v. Mem'l Hosp., 86 F.3d 1391, 1393 (5th Cir. 1996) (hospital's exclusive contract with physician to supervise kidney disease center was a foreseeable result of statute authorizing municipal hospitals to enter into contracts for the provision of services); Independent Taxicab Drivers' Employees v. Greater Houston Transp. Co., 760 F.2d 607, 610–11 (5th Cir. 1985) (city's exclusive contract with Yellow Cab to provide taxicab service at airport was a foreseeable result of statute authorizing city to enter into contracts for the provision of services at the airport).

[63] *See* Sterling Beef Co. v. City of Fort Morgan, 810 F.2d 961, 963–64 (10th Cir. 1987) (city's refusal to permit its largest gas customer to build a pipeline on its own property to link to an external source was a foreseeable result of statute authorizing municipalities to acquire gas distribution systems).

[64] *See* FTC STATE ACTION REPORT, *supra* note 60, at 37–40.

[65] Crosby v. Hospital Auth., 93 F.3d 1515, 1524–25 (11th Cir. 1996).

[66] Bankers Ins. Co. v. Florida Residential Prop. & Cas. Joint Underwriting Ass'n, 137 F.3d 1293, 1296–97 (11th Cir. 1998). Professors Areeda and Hovenkamp are particularly skeptical of the notion that an entity's "lack of possibility of private profit" suggests that active supervision is unnecessary. *See* 1 PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 227A, at 500 (2d ed. 2000) ("[M]any antitrust defendants have been nonprofit corporations that acted anticompetitively in behalf of themselves and their members. Indeed, the typical or professional association is *itself* a nonprofit organization dedicated to improving the welfare of its members.").

inquiry's true objective of proving, or disproving, a unity of purpose between the defendant and the state.

B. One Possible Alternative: A "Tiered" Approach

One seemingly simple way to address the disconnect between the philosophical underpinnings of the state action doctrine, which are increasingly rooted in public choice theory, and the current analytical framework, which remains mired in public interest theory, would be to update the outdated analytical framework. One promising alternative would be to adopt a "tiered" approach to state action. This approach, which was briefly described in the FTC's *State Action Report*,[67] recognizes that both the "clear articulation" and "active supervision" requirements have been weakened though uniform application to vastly different factual circumstances. In order to escape this one-size-fits-all paradigm, a tiered approach would vary the level of clear articulation and active supervision required based on two key factors: (1) the nature of the anticompetitive conduct and (2) the nature of the entity engaging in the conduct. Such an approach would be far more consistent with the state action doctrine's current roots in public choice theory, as it would place the focus on the analysis squarely on the defendant's political and economic incentives.

Pursuant to such a tiered approach, the level of clear articulation required would increase or decrease, depending on the nature of the anticompetitive conduct at issue. This approach reflects that fact that, the more serious the nature of the anticompetitive conduct, the more likely it is to restrain trade. Thus, it is logical to assume that the alleged beneficiary of a restraint will be more likely to engage in more serious anticompetitive conduct as such conduct is also more likely to be successful. Increasing the level of clear articulation required to match the seriousness of the alleged anticompetitive conduct should therefore create at least a rough link between the defendant's incentives and a grant of state action protection, with the result that the "clear articulation" requirement will be most rigorous where the defendant is most likely to engage in anticompetitive conduct.

Similarly, the level of active supervision required would increase or decrease depending on the nature of the entity engaging in the conduct. The goal of this aspect of the tiered approach is, once again, to tailor the rigor of the *Midcal* analysis to the incentives of the defendant. Thus, where the defendant has strong incentives to pursue its own objectives,

---

[67] *See* FTC State Action Report, *supra* note 60, at 12.

as opposed to those of the state, one would expect the required level of active supervision to increase. In contrast, where the incentives of the defendant are closely aligned with those of the state, one would expect a corresponding lower level of required supervision.

IV. CONCLUSION

One of the objectives of the FTC's 90th Anniversary Symposium was to examine not only the history of the agency but the history of the competition laws it enforces. This endeavor was not intended to be completely backward looking but rather to inform the future development of competition law and policy. A careful examination of the roughly sixty years of evolution of the state action doctrine reveals the utility of this enterprise. As the 21st century dawned, there was widespread concern within the Bar that the scope of the state action doctrine had grown too broad.[68] Looking only to the recent past, however, offered few solutions. Only a longer, more historical perspective reveals the subtle, but critical, shift from the emerging state action doctrine of 1943, grounded in public interest theory, to the current doctrine, grounded in public choice theory. Identification and, more importantly, understanding of this shift will hopefully lead not only to important insights regarding the roots of *Parker*, but to promising new approaches for more closely tailoring the scope of the state action doctrine to the needs of today's consumers, businesses, regulators, and courts.

---

[68] *See, e.g.*, AMERICAN BAR ASSOCIATION SECTION OF ANTITRUST LAW, THE STATE OF ANTITRUST ENFORCEMENT—2001, REPORT OF THE TASK FORCE ON THE FEDERAL ANTITRUST AGENCIES—2001, at 42–43 (2001), *available at* http://www.abanet.org/antitrust/comments/2001/reports.html.