

CPI Antitrust Chronicle

April 2015 (2)

Rediscovering Capture: Antitrust Federalism and the *North Carolina Dental Case*

Herbert Hovenkamp
Univ. of Iowa College of Law

Rediscovering Capture: Antitrust Federalism and the *North Carolina Dental Case*

Herbert Hovenkamp¹

I. INTRODUCTION

The federal antitrust laws are concerned almost entirely with private restraints. The Sherman Act's legislative history provides little evidence that Congress intended for antitrust to ride herd on anticompetitive or badly designed state regulation. The question itself is anachronistic, however. In 1890 and even in 1914 when the Clayton Act was passed the prevailing interpretation of the Commerce Clause would have precluded the reach of federal antitrust into internal state economic policy, to say nothing of the policy of local governments. For their part, the states in the late nineteenth century were precluded from regulating conduct that crossed a state line.²

Conflicts between federal antitrust law and state regulation did not frequently arise prior to the Supreme Court's 1942 decision in *Wickard v. Filburn*,³ which expanded federal power to reach conduct or transactions that "affected" interstate commerce. Following *Wickard*, the Court held a few years later in *Women's Sportswear Manufacturing* that the Sherman Act reached a completely intrastate cartel of garment stitchers when their product was later shipped across state lines.⁴

During the era of "dual federalism" that prevailed in the 1930s and earlier, federal power did not reach activity unless it encompassed more than a single state, and the states had power to regulate only within their borders. One important exception permitting state extraterritorial control was corporation law. Early in the twentieth century some states began to authorize their corporations to do business outside the state and also to acquire equity interest in other corporations, or corporate mergers.⁵ Already in 1904, however, the Supreme Court held that the legality of an interstate corporate merger under state corporation law did not immunize the transaction from the Sherman Act.⁶ While the merger in question was accomplished through a New Jersey incorporation act that permitted holding companies, the railroads involved operated between the Great Lakes and the West Coast, entirely outside of that state and quite far from it. In condemning the merger under Section 1 of the Sherman Act, the Supreme Court did not question New Jersey's power to authorize an extraterritorial transaction in this fashion—

¹ Ben V. & Dorothy Willie Professor, Univ. of Iowa College of Law.

² E.g., *Wabash, St. Louis & Pac. Rwy. Co. v. Illinois*, 116 U.S. 557 (1886) (negative Commerce Clause precluded state from price regulating even the intrastate portion of an interstate route).

³ 317 U.S. 111 (1942).

⁴ *United States v. Women's Sportswear Mfg. Ass'n*, 336 U.S. 460, 464 (1949).

⁵ See HERBERT HOVENKAMP, *ENTERPRISE AND AMERICAN LAW, 1836-1937* at 56-66 (1991).

⁶ *Northern Securities Co. v. United States*, 193 U.S. 197, 345-346 (1904).

however, in doing so it could not interfere with national competition policy over interstate commerce: "It cannot be said that any state may give a corporation...authority to restrain interstate...commerce against the will of...Congress."⁷

Serious conflicts between state power to regulate internal markets and federal antitrust emerged after the full implications of *Wickard v. Filburn* became obvious for areas that were traditionally subject to state regulation. In the *South-Eastern Underwriters* case (1944) the Supreme Court extended federal antitrust law to the business of insurance, a market that had traditionally been regulated entirely by state law.⁸ That decision soon prompted federal legislation, the McCarran-Ferguson Act, which restored insurance regulation to the states and granted a partial antitrust immunity.⁹ The Supreme Court first acknowledged the modern "state action" antitrust exemption for state-sanctioned conduct in *Parker v. Brown*.¹⁰ The principal difference between the *Women's Sportswear* case and *Parker* was that the cartel in the former case was purely private, while the raisin cartel in *Parker* was initiated and managed by the state.

The *South-Eastern Underwriters* decision and subsequent passage of the McCarran-Ferguson Act serves as a good object lesson: If the Supreme Court does interpret statutory federal antitrust policy in a way that diminishes state power, Congress can always intervene. It did so again with the Local Government Antitrust Act,¹¹ which responded to the Supreme Court's liability-expanding *Boulder* decision by largely taking damages off the table.¹²

The expansion of federal commerce power naturally invited reconsideration of one of the most central concerns of federalism: namely, the power of state governments to regulate their own economies in the face of conflicting federal policies favoring competition.¹³ The resulting antitrust principles were judge-made, although they at least purported to be inferred from congressional intent:

First, it seems clear that Congress never intended to displace sovereign state regulation of their own internal economies in any significant way, and most of the legislative history of federal antitrust speaks of federal-state cooperation rather than preemption.¹⁴

Second, however, nothing prevents the federal antitrust laws from being applied to private economic conduct within their reach, even under an affecting commerce test. Indeed, Congress itself has spoken on this issue. While the language of the Sherman Act is very broad, the original language of the substantive Clayton Act and FTC Act provisions was not, reaching only restraints

⁷ *Id.* at 346.

⁸ *United States v. South-Eastern Underwriters Ass'n*, 322 U.S. 533 (1944). On the traditional view, see *Paul v. Virginia*, 75 U.S. 168, 183–84 (1868).

⁹ 15 U.S.C. §§ 1101–1102; see 1A PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶219 (4th ed. 2013).

¹⁰ *Parker v. Brown*, 317 U.S. 341 (1943).

¹¹ 1A AREEDA & HOVENKAMP, *supra* note 9, ¶223d.

¹² *Cnty. Commc'ns Co., Inc. v. City of Boulder*, 455 U.S. 40, 65 n.2 (1982); Local Government Antitrust Act, Pub. L. 98-544, 98 Stat. 2750 (1984), 15 U.S.C. §§34-36. See 1A AREEDA & HOVENKAMP, *supra* note 9, ¶223c.

¹³ On concerns of federalism that arose in the wake of *Wickard*, see HERBERT HOVENKAMP, THE OPENING OF AMERICAN LAW: NEOCLASSICAL LEGAL THOUGHT, 1870-1970 at 294-298 (2015).

¹⁴ See Herbert Hovenkamp, *State Antitrust in the Federal Scheme*, 58 IND.L.J. 375 (1983).

in the actual course of interstate commerce. That limitation reflected the dual federalism of the period in which the Clayton Act was passed.¹⁵ However, after the *Wickard* principle was well established Congress amended Section 5 of the Federal Trade Commission Act in 1975¹⁶ and Section 7 of the Clayton Act in 1980¹⁷ so as to reach restraints "in or affecting" commerce. It chose not to amend Sections 2 and 3 of the Clayton Act, dealing with price discrimination and tying.¹⁸

The "commerce" delimiter on federal authority is also very important for identifying the proper scope of antitrust federalism. The federal antitrust laws are passed under the commerce power, and they explicitly apply only to restraints that affect commerce.¹⁹ They were never intended to be a device for ensuring good government. State and local governments might pass a wide variety of very bad laws that do not implicate federal antitrust policy for the simple reason that they have nothing to do with commerce. Further, the Tenth Amendment is designed to prohibit federal encroachment on state regulatory prerogatives, and also acts as an important break on federal legislation passed under the commerce power.²⁰

The distinction between "private" conduct and the conduct of a sovereign state is critical in the post-*Wickard* world. If a state is regulating within its territory *and* it is actually the state that is doing the regulating, then the highly general language of the antitrust laws generally requires federal antitrust tribunals to stand aside. Federal antitrust has no power to police bad state regulation as such. It cannot require that state regulations pass a cost-benefit test that might weed out some instances of badly designed regulation.²¹ But it can properly insist on a showing that the conduct in question be that of the state, and not of a private entrepreneur.

The antitrust "state action" doctrine addresses this problem by trying to identify the line between sovereign state conduct, which is largely immune from federal antitrust oversight, and private conduct, which is not. After nearly forty years of litigation the Supreme Court adopted the modern two-prong "*Midcal*" test,²² which after subsequent elaboration, states:

1. "Sovereign" conduct performed by the "state" itself is immune; and
2. "Private" conduct must be both (a) authorized by the state, and (b) any anticompetitive consequences must be "actively supervised" by a government official.

These prongs have been further refined:

¹⁵ E.g., *United States v. E.C. Knight Co.*, 156 U.S. 1 (1895); *Hammer v. Dagenhart*, 247 U.S. 251 (1918) (applying *E.C. Knight* to strike down federal child labor provision). See HOVENKAMP, OPENING, *supra* note 13 at 278-299.

¹⁶ 15 U.S.C. §45(a)(2).

¹⁷ 94 Stat. 1159, 15 U.S.C. §18.

¹⁸ See 1A AREEDA & HOVENKAMP, *supra* note 9, ¶¶265, 267.

¹⁹ See *id.*, ¶ ¶260-262.

²⁰ On the Tenth Amendment as a constraint on federal antitrust law, see *id.*, ¶¶215-217.

²¹ Cf. Exec. Order No. 12291 (President Ronald Reagan), 46 FR 13193 (Feb. 17, 1981). See Michael A. Livermore & Richard L. Revesz, *Regulatory Review, Capture, and Agency Inaction*, 101 GEO. L.J. 1337 (2013); Richard L. Revesz, *Quantifying Regulatory Benefits*, 102 CAL. L. REV. 1423 (2014).

²² From *Cal. Retail Liquor Dealers Ass'n, v. Midcal Aluminum*, 445 U.S. 97 (1980), hereinafter "*Midcal*." See 1A AREEDA & HOVENKAMP, *supra* note 9, ¶ 221f.

3. In between the extremes defined by numbers (1) and (2) is conduct by state-created government subdivisions that are not “sovereign” under the United States Constitution (although they may be under state law); for these, the challenged activity must be “authorized” but it need not be “supervised;” and
4. The issue whether conduct is "private" or that of a state-created subdivision presents a federal question; that is, a state legislature's designation of a private group as an "agency" of the state does not necessarily make it so.²³

The question in *North Carolina Dental*, which was decided by the Supreme Court in February, 2015, was whether the conduct in question fell more closely to number (2), the Court’s majority conclusion, or number (3), which was the conclusion of the dissent. Question (4) also divided the majority from the dissenters.

This multi-stage, judge-made set of inquiries is intended to enable the federal courts to walk the very thin and indistinct line that defines the relationship between the federal government and the states in the making of competition and regulatory policy. In some cases placing the line is easy. For example, the governor, legislators and judges are state employees who exercise sovereign power. This is true even though the state legislature is composed of part-time members who also have their own businesses and whose decisions as legislators may be affected and even biased.

An important brake here is that legislative action must generally be signed by the Governor before it becomes law. Another is that the state's highest executive, legislative, and judicial branches are multi-sectoral, facing competing pressures from diverse constituencies. A third is that most of these officials are answerable to the electorate. To one degree or another all of these three considerations also apply to the highest officials in municipal government. They do not necessarily apply, however, to specialized state agencies that may represent producers in a single market, be composed largely of interested decision-makers in that market, and often are not directly accountable to either the electorate or higher reviewers.

As formulated, the state action doctrine is not concerned with geographic spillovers. Insofar as antitrust state action is concerned, the courts generally do not care whether the state itself experiences most of the harmful effects of anticompetitive decisions rather than exporting them to other states. As a result, the doctrine authorizes federal antitrust policy to dig into local and intrastate issues, even to the point of rescuing the state from its own improvident decisions. The doctrine is less concerned with one state's power to impose anticompetitive harm on other states, and more concerned with ensuring that each state's own processes are transparent and actually reflect articulated state policy. The dissenters in *North Carolina Dental* did not pick up on this point.

II. THE NORTH CAROLINA DENTAL EXAMINERS CASE

A. The Decision

The *North Carolina Dental Examiners* case²⁴ is the second time in two years that the Supreme Court rejected a "state action" defense to an anticompetitive arrangement that had been

²³ See *id.*, ¶¶224-227, which develops each of these factors.

approved under state law and that very likely visited any competitive harm almost entirely on its own residents. In *Phoebe Putney* the Court unanimously held that a state statute that permitted two hospitals to merge did not authorize an anticompetitive merger to monopoly. As a result, it did not immunize the transaction from an antitrust challenge.²⁵

In both cases the problems that the Supreme Court identified are fixable by state legislation, although the legislation would require greater transparency about the interests that the state was protecting. The facts of both cases suggested—but the Court did not consider—whether it should be relevant that the anticompetitive conduct in question was harmful mainly to the state's own residents. If state-sanctioned anticompetitive conduct harms mainly that state's own citizens should federal authorities be less concerned?

The dispute in the *Dental Examiners* case reduced to one question: To what extent can a state simply designate a private group as a state “agency” for purposes of asserting state sovereignty, permitting all decision-making to be made by the unsupervised power of the market participants themselves, and without review by a superior and independent state official? The result may amount to a naked cartel, harming its customers wherever they are located.

This question arose in the very first state action decision, *Parker v. Brown*, where the raisin cartel in question had market power within the state but exported 90 percent of its product to other states.²⁶ In addition to the antitrust claim the Court also considered and rejected the challenger's argument that the raisin cartel program unconstitutionally burdened interstate commerce.²⁷ A somewhat similar case, *Goldfarb*,²⁸ involved the inadequately supervised fee setting of a state bar, presumably providing legal services to clients both inside and outside the state.²⁹

In *N.C. Dental*, by contrast, it seems clear that most of the consumers injured by the dental board's restrictions on teeth whitening were within the state.³⁰ Indeed, to the extent the dental board's rule limiting the provision of teeth-whitening services to licensed dentists caused competitive harm, it would have encouraged North Carolina consumers to obtain their teeth whitening outside of the state or look for means (such as self-treatment) that were either outside the reach of the rule or else difficult to detect. The same thing was likely true in the *Phoebe Putney* case, involving a rural hospital in central Georgia that very likely served mainly Georgia residents.³¹

²⁴ *N. C. State Board of Dental Examiners v. FTC*, 135 S.Ct. 1101 (2015), hereinafter “*N.C. Dental*.”

²⁵ *FTC v. Phoebe Putney Health Sys.*, 133 S.Ct. 1003 (2013).

²⁶ *Parker v. Brown*, 317 U.S. 341 (1943).

²⁷ *Id.* at 359-361.

²⁸ *Goldfarb v. Va. State Bar*, 421 U.S. 773 (1975).

²⁹ The district court observed that a significant number of purchasers of title insurance in Fairfax County, Virginia, worked outside the state. See 355 F. Supp. 491, 494 (E.D. Va. 1973).

³⁰ The Federal Trade Commission spoke of harm to “consumers in North Carolina,” but did not quantify the percentage in its opinion. See *In re North Carolina Board of Dental Examiners*, 152 F.T.C. 75 (2011), fact finding #158.

³¹ See the FTC's decision, 2013 WL 4627512 (Aug. 22, 2013) (limiting geographic market to a six county area). While the Commission did not reference the Elzinga-Hogarty test for a geographic market, it applied 90 percent of

A divided (6-3) Supreme Court³² agreed with the Fourth Circuit and the Federal Trade Commission that the state dental board's restriction violated the antitrust laws because it was not adequately supervised by a sufficiently independent state decision-maker. The regulatory board in question was controlled by a majority actively engaged in the practice of dentistry.³³ A state statute provided that this Board was "the agency of the State for the regulation of the practice of dentistry,"³⁴ and it had authority over licensing as well as power to discipline the unlawful practice of dentistry.³⁵ Nothing in the statute, however, identified teeth whitening as part of the practice of dentistry.³⁶ Under the Act, six of the Board's eight members must be actively practicing dentists, and these members were elected by other licensed dentists practicing in North Carolina. A seventh member was required to be a dental hygienist, and an eighth "consumer" member was appointed by the Governor.³⁷

Dentists in North Carolina began whitening teeth in the 1990s, earning substantial fees. In the early 2000s, however, non-dentists entered into competition with them and charged lower fees, some of them operating from facilities such as cosmetic salons or kiosks in shopping malls.³⁸ The Board received numerous complaints from dentist members. Most of these complaints were about the lower fees, although some also complained of possible harm to consumers.³⁹ The Board began an investigation conducted by several dentist members of the Board, but excluding the hygienist and consumer members. Beginning in 2005 the Board sent out numerous cease-and-desist letters to non-dentists performing teeth-whitening services.⁴⁰ At that point the FTC filed its complaint, challenging the rule limiting teeth whitening to licensed dentists and the use of the cease-and-desist letters. It concluded that the Board's conduct was a trade restraint prohibited by Section 5 of the FTC Act and was not immunized by the "state action" doctrine.⁴¹ The Fourth Circuit agreed.⁴²

The Supreme Court rejected the Board's argument that because its members "were invested by North Carolina with the power of the State," its actions required neither authorization nor supervision in order to be free of antitrust scrutiny. "Here, the Board did not receive active supervision by the State when it interpreted the Act as addressing teeth whitening and when it enforced that policy by issuing cease-and-desist letters to non-dentist teeth

patients would have had to come from this area; See 2A PHILLIP E. AREEDA, HERBERT HOVENKAMP, ROGER D. BLAIR, & CHRISTINE PIETTE DURRANCE, ANTITRUST LAW ¶550a3.

³² Justice Kennedy's majority opinion was joined by C.J. Roberts and Justices, Ginsburg, Breyer, Sotomayor, and Kagan. Justice Alito dissented, joined by Justices Scalia and Thomas.

³³ *Id.* at 1107.

³⁴ *Id.*, quoting N. C. Gen. Stat. Ann. §90-22(b) (2013).

³⁵ *N. C. Dental*, 135 S.Ct. at 1107, citing *Id.*, §90-40.1.

³⁶ *Id.* at 1108.

³⁷ *Id.*

³⁸ See the Fourth Circuit's opinion, *N.C. State Bd. of Dental Examiners v. F.T.C.*, 717 F.3d 359, 364 (4th Cir. 2013).

³⁹ *N.C. Dental*, 135 S.Ct. at 1108.

⁴⁰ *Id.*

⁴¹ 152 F.T.C. 75 (2011).

⁴² *N.C. State Bd. of Dental Examiners v. F.T.C.*, 717 F.3d 359 (4th Cir. 2013).

whiteners."⁴³ A grant of "state action" immunity applies only to "exercise[s] of the State's sovereign power."⁴⁴ That status "requires more than a mere facade of state involvement...."⁴⁵ The Court then observed:

Limits on state-action immunity are most essential when the State seeks to delegate its regulatory power to active market participants, for established ethical standards may blend with private anticompetitive motives in a way difficult even for market participants to discern. Dual allegiances are not always apparent to an actor. In consequence, active market participants cannot be allowed to regulate their own markets free from antitrust accountability.....So it follows that, under *Parker* and the Supremacy Clause, the States' greater power to attain an end does not include the lesser power to negate the congressional judgment embodied in the Sherman Act through unsupervised delegations to active market participants.

... *Parker* immunity requires that the anticompetitive conduct of nonsovereign actors, especially those authorized by the State to regulate their own profession, result from procedures that suffice to make it the State's own.⁴⁶

Speaking then of the immunity requirements of clear articulation (authorization) and active supervision,⁴⁷ the Court observed:

The first requirement—clear articulation—*rarely* will achieve that goal by itself, for a policy may satisfy this test yet still be defined at so high a level of generality as to leave open critical questions about how and to what extent the market should be regulated.... Entities purporting to act under state authority might diverge from the State's considered definition of the public good. The resulting asymmetry between a state policy and its implementation can invite private self-dealing. The second *Midcal* requirement—active supervision—seeks to avoid this harm by requiring the State to review and approve interstitial policies made by the entity claiming immunity.⁴⁸

Turning to the active supervision requirement,⁴⁹ the Court noted that municipalities were exempted from it because "there is little or no danger" that they might be involved "in a private price fixing arrangement."⁵⁰ Rather, the principal danger from municipal regulation was that the municipality might "seek to further purely parochial public interests at the expense of more overriding state goals."⁵¹ In addition, municipalities are "electorally accountable" entities, and they exercise regulatory power "across different economic spheres, substantially reducing the risk

⁴³ 135 S.Ct. at 1110.

⁴⁴ *Id.*, citing *Columbia v. Omni Outdoor Advertising, Inc.*, 499 U.S. 365, 374 (1991).

⁴⁵ 135 S.Ct. at 1111, citing *FTC v. Ticor Title Ins. Co.*, 504 U.S. 621, 636 (1992); and referring *Parker v. Brown*, 317 U.S. 341 (1943).

⁴⁶ *Id.* at 1111, citing 1A ANTITRUST LAW ¶226; Einer Elhauge, *The Scope of Antitrust Process*, 104 HARV. L. REV. 667, 672 (1991); and Merrick B. Garland, *Antitrust and State Action: Economic Efficiency and the Political Process*, 96 YALE L. J. 486, 500 (1986).

⁴⁷ From *Midcal*, *supra* note 22. See 1A ANTITRUST LAW ¶¶224-227.

⁴⁸ *N.C. Dental*, 135 S.Ct. at 1112 (emphasis added), referring to *Midcal*, *supra* note 22.

⁴⁹ See 1A ANTITRUST LAW ¶223.

⁵⁰ *N.C. Dental*, 135 S.Ct. at 1112.

⁵¹ *Id.* at 1112, quoting *Hallie v. Eau Claire*, 471 U.S. 34, 47 (1985).

that they would pursue private interests while regulating any single field."⁵² In the case of municipalities, the *Omni* case had gone one step further, rejecting subjective tests for "corruption" that would have forced a "deconstruction of the governmental process" by engaging in "ad hoc and ex post questions of their motives for making particular decisions."⁵³

After examining its earlier decisions, the Court drew a "clear" lesson that "*Midcal's* active supervision test is an essential prerequisite of *Parker* immunity for any non-sovereign entity—public or private—controlled by active market participants."⁵⁴ As a result, the need for active supervision by the state itself turns "not on the formal designation given by States to regulators but on the risk that active market participants will pursue private interests in retraining trade."⁵⁵ Further, "State agencies controlled by active market participants, who possess singularly strong private interests, pose the very risk of self-dealing *Midcal's* supervision requirement was created to address."⁵⁶

The court then observed that the Court's statement in *Hallie* "that active state supervision would also not be required" of state agencies was *dicta*, given that the defendant in that case was "an electorally accountable municipality with general regulatory powers and no private price fixing agenda." As a result, the municipality resembled a traditional state agency rather than "specialized boards dominated by active market participants."⁵⁷ As a result,

The similarities between agencies controlled by active market participants and private trade associations are not eliminated simply because the former are given a formal designation by the State, vested with a measure of government power, and required to follow some procedural rules.⁵⁸ *Parker* immunity does not derive from nomenclature alone. When a State empowers a group of active market participants to decide who can participate in its market, and on what terms, the need for supervision is manifest. The Court holds today that a state board on which a controlling number of decision makers are active market participants in the occupation the board regulates must satisfy *Midcal's* active supervision requirement in order to invoke state-action antitrust immunity.⁵⁹

The Court then discussed and rejected the Board's argument that the prospect of treble damages would discourage citizens from public participation on such boards. It noted, first, that this particular case, brought by the FTC, was not such a situation, and provided no occasion to address the separate question of citizen members' liability for damages. Further, the state could always provide for defense and indemnification of such members.⁶⁰

⁵² 135 S.Ct. at 1113.

⁵³ *Id.* at 1113, citing *Columbia v. Omni Outdoor Advertising, Inc.*, 499 U.S. 365, 374 (1991).

⁵⁴ *Id.* at 1113, referring to *Midcal*, *supra* note 22. See 1A ANTITRUST LAW ¶221f.

⁵⁵ 135 S.Ct. at 1114.

⁵⁶ *Id.*, citing 1A ANTITRUST LAW ¶227.

⁵⁷ 135 S.Ct. at 1114. Further, "[t]here is no doubt that the members of such associations often have economic incentives to restrain competition and that the product standards set by such associations have a serious potential for anticompetitive harm." *Id.* at 1114, quoting *Allied Tube & Conduit Corp. v. Indian Head, Inc.*, 486 U.S.492, 500 (1988).

⁵⁸ Citing *Hallie*, 471 U.S. at 39, as "rejecting 'purely formalistic' analysis."

⁵⁹ *N.C. Dental*, 135 S.Ct. at 1114, citing 1A ANTITRUST LAW ¶227.

⁶⁰ 135 S.Ct. at 1115.

The Court also rejected the argument that the Board's decision in this case should be treated as a type of "peer review," which is "essential to the provision of quality medical care," and that the specter of antitrust damages would act as a deterrent to such review. The Court concluded that this argument is more properly addressed to the "legislative branch," apparently referring to either Congress or the relevant state legislature.⁶¹

Finally, the Court observed that active supervision was lacking in this case. Teeth whitening was not covered by the statutory provisions creating the Board and stating its duties and powers. Further, in this case the Board had acted against putative offenders by means of unilaterally sent "cease-and-desist letters threatening criminal liability, rather than any of the powers ... that would invoke oversight by a politically accountable official."⁶² It did not mean to suggest that a more judicially involved process, such as a request for a preliminary injunction, would have qualified as supervision unless judicial review in that context actually reached the competitive merits of the requested action. Nevertheless, the Court also stated:

Active supervision need not entail day-to-day involvement in an agency's operations or micromanagement of its every decision. Rather, the question is whether the State's review mechanisms provide "realistic assurance" that a nonsovereign actor's anticompetitive conduct "promotes state policy, rather than merely the party's individual interests."⁶³

The Court then provided a list of requirements for qualifying active supervision. *First*, the state supervisor "must review the substance of the anticompetitive decision, not merely the procedures followed to produce it."⁶⁴ Further, the relevant supervisor "must have the power to veto or modify particular decisions to ensure they accord with state policy," and the "mere potential" for such supervision is inadequate.⁶⁵ Finally, "the state supervisor may not itself be an active market participant. In general, however, the adequacy of supervision otherwise will depend on all the circumstances of a case."⁶⁶

B. Dissent

Justice Alito's dissent found the majority's reasoning to be "based on a serious misunderstanding" of the antitrust state action doctrine.⁶⁷ For him, the Court took "the unprecedented step of holding that *Parker* does not apply to the North Carolina Board because the Board is not structured in a way that merits a good-government seal of approval."⁶⁸

Justice Alito then stated categorically that "Under *Parker*, the Sherman Act...and the Federal Trade Commission Act...do not apply to state agencies; the North Carolina Board of Dental Examiners is a state agency; and that is the end of the matter."⁶⁹ Returning to this issue

⁶¹ *Id.* at 1116, citing Aaron Edlin & Rebecca Haw, *Cartels by Another Name: Should Licensed Occupations Face Antitrust Scrutiny?*, 162 UNIV. PA. L. REV. 1093 (2014).

⁶² 135 S.Ct. at 1116.

⁶³ *Id.* at 1116.

⁶⁴ *Id.* at 1116, citing *Patrick v. Burget*, 486 U.S. 94, 102-103 (1988).

⁶⁵ 135 S.Ct. at 1116, citing *Patrick, Id.*; *FTC v. Ticor Title Ins. Co.*, 504 U.S. 621, 638 (1992).

⁶⁶ 135 S.Ct. at 1117.

⁶⁷ *Id.* at 1117 (Alito, J., dissenting, joined by Justices Scalia and Thomas).

⁶⁸ *Id.* at 1117.

⁶⁹ *Id.* at 1117-1118.

later, he concluded that the state of North Carolina had had an "agency" in mind when it passed the legislation creating the dental board.⁷⁰ "As this regulatory regime demonstrates, North Carolina's Board of Dental Examiners is unmistakably a state agency created by the state legislature to serve a prescribed regulatory purpose and to do so using the State's power in cooperation with other arms of state government."⁷¹

Justice Alito also observed that self-regulation of dentistry long antedated the Sherman Act.⁷² Further, when the antitrust laws were originally passed the scope of the Commerce Power was much narrower than it is today. "As a result, the Act did not pose a threat to traditional state regulatory activity," which generally applied only within its own borders.⁷³ Further, "In 1890, the regulation of the practice of medicine and dentistry was regarded as falling squarely within the States' sovereign police power."

Like the majority, he also parsed earlier decisions, finding instances such as *Parker* itself that found immunity for purely private, self-interested conduct.⁷⁴ While *Midcal* had required active state supervision, the party claiming immunity in that case was a private trade association, not a state agency.⁷⁵ Justice Alito preferred to liken the dental agency in the present case to the municipality in *Hallie*. He found it "puzzling" that the majority treated the dental Board "less favorably than a municipality."⁷⁶ Municipalities, he noted, are not sovereign, while agencies can and do exercise sovereign state functions.

C. Analysis

All members of the Court, including the three dissenters, agreed with the lower tribunals that active supervision was not present. The legal conclusions they drew were starkly different. The majority believed that state authorization was "rarely" sufficient standing alone, that it must usually be accompanied by supervision, and that supervision by a market participant never suffices.⁷⁷ Municipalities and agencies in which a controlling number of decision-makers are either disinterested public officials or else persons other than active market participants may qualify. By contrast, the dissenters believed that authorization was sufficient any time the relevant actor had been designated by the state as an "agency," without regard to the interested and active market participation of the agency's decision-makers.

On the exemption from the active supervision requirement given to municipalities, the majority emphasized one set of points—namely, (i) that municipal decision-making is most frequently made by disinterested public officials, (ii) that municipalities are "multi-sector," with regulatory obligations in many areas, and (iii) that most of the state action issues pertain to municipal decisions that are excessively parochial rather than blatant trade restraints such as

⁷⁰ *Id.* at 1118.

⁷¹ *Id.* at 1120.

⁷² *Id.* at 1118.

⁷³ *Id.* For development of this proposition, see HOVENKAMP, OPENING OF AMERICAN LAW, *supra* note 13 at 296-298.

⁷⁴ 135 S.Ct. at 1119-1121, discussing *Parker v. Brown*, 317 U.S. 341, 347-351 (1943).

⁷⁵ 135 S.Ct. at 1121.

⁷⁶ *Id.* at 1122.

⁷⁷ *Id.* at 1112.

price-fixing or market exclusion.⁷⁸ For the dissenters, the main significance was that municipalities were non-sovereign institutions of local government, while agencies were created in order to carry out state policy.⁷⁹

On the nature of the likely restraints, the majority's observation that municipalities rarely engage in naked price-fixing or exclusion but are more likely to regulate for parochial or territorial reasons is generally justified by the case law. Typical municipally imposed restraints are things like tying of electric service to waste pick-up, use of land use provisions to limit providers, or limitations on ambulance or airport taxi access.⁸⁰ By contrast, *Parker, Midcal, Goldfarb*, and *N.C. Dental* all involved participant-created price or output control that would have been *per se* unlawful at the time of those decisions. Further, while Justice Alito found it puzzling that the majority should treat agencies less favorably than municipalities, in fact the test that the majority created applied to both. Municipalities are entitled to regulate without independent state supervision because they act largely through elected government officials accountable through the political process. Presumably, if they should cede this power to an "agency" of active market participants—say, a taxicab commission composed of taxi owners—they would also be subject to the supervision requirement under the majority's analysis.

To be sure, municipalities cover a limited territory while state agencies often operate state wide, as the Board of Dental Examiners did. But that distinction has little relevance for purposes of assessing sovereign power. The more important differences are that the municipality is "multi-sector," dealing with nearly the same range of regulatory issues that state government controls. This is particularly true of larger "home rule" cities that typically have most of the regulatory power of states, but limited to their own borders.⁸¹ In that setting the interests of one entrepreneurial group are more likely to be offset by those of a different group. Single-sector agencies, by contrast, typically have members whose interests are aligned—such as practicing dentists, all of whom could profit from a teeth-whitening cartel. Further, municipalities have their own internal political processes, and their decisions-makers are answerable to the electorate.

Both sides also agreed that the Dental Board's actions in this case were an instance of special interest agency "capture." They drew different conclusions from that premise as well. The majority embraced and the dissent rejected a link between the state action doctrine and special interest capture. Indeed, the dissent noted that in *Parker v. Brown*, the grandparent of state action cases, the relevant decision-makers were all market producers.⁸²

The dissent drew strong conclusions from the fact that regulation of dentistry was traditionally an intrastate activity that the Sherman Act very likely could not have reached at the time it was passed. That changed with the Supreme Court's *Wickard* case in 1942, which brought such markets within the reach of federal law provided that they had a sufficient effect on

⁷⁸ *Id.* at 1112.

⁷⁹ *Id.* at 1121–1122.

⁸⁰ For analysis of the decisions, see 1A ANTITRUST LAW ¶223.

⁸¹ See *Id.*, ¶223c.

⁸² *N. C. Dental*, 135 S.Ct. at 1121.

interstate commerce.⁸³ What the dissent did not note is that the present case was brought under §5 of the Federal Trade Commission Act, because the FTC has no direct authority to enforce the Sherman Act. At the time of *Wickard* and *Parker*, the FTC Act reached only activities "in commerce," but thirty years later it was amended to embrace all matters "in or affecting commerce," thus tracking the *Wickard* language.⁸⁴ Congress clearly intended for the FTC Act to reach intrastate activities that affect commerce.

One portion of the dissent's argument seems anachronistic. The dissenters dwelt at some length on *Parker*, which immunized what amounted to a state-sanctioned raisin cartel without assessing any kind of supervision by a disinterested state actor.⁸⁵ For decades the Court struggled with the meaning of this decision, at one time suggesting that it required "compulsion."⁸⁶ It did not develop the modern two-prong test requiring "clear articulation" and "active supervision" (but not compulsion) until *Midcal* in 1980.⁸⁷ Already in *Goldfarb*, however, the Court held that minimum price schedules promulgated by the Virginia Bar Association were not immune, in part because no independent agency—referring in this case to the Virginia Supreme Court—supervised them.⁸⁸ On this point *Goldfarb* and the dissent seem quite inconsistent, and the dissent did not attempt to resolve the conflict. In any event, the current majority was certainly not taking an "unprecedented step" as the dissent suggested.⁸⁹

The dissenters' position that once a state-created "agency" is found, state action immunity for authorized conduct is automatic is hardly a foregone conclusion from the case law. The State Bar Association in *Goldfarb* had been designated "a state agency by law" in a 1938 statute creating an integrated state bar.⁹⁰ The *Ticor* decision, which also involved state regulatory agencies, is somewhat different. There the "rating bureaus" were simply private cartels of title insurers, and

⁸³ *Id.* at 1118, citing *Wickard v. Filburn*, 317 U.S. 111, 125 (1942).

⁸⁴ 88 Stat. 2193, 15 U.S.C.A. §45. See H.R. Rep. No. 1107, 93 Cong., 2d Sess., 29-31 (1974).

⁸⁵ See *N.C. Dental*, 135 S.Ct. at 1118–1121.

⁸⁶ See, e.g., *Cantor v. Detroit Edison*, 428 U.S. 579, 637 (1976) ("*Goldfarb* clarified *Parker* by holding that private conduct, if it is to come within the state-action exemption, must be not merely "prompted" but "compelled" by state action); *Goldfarb v. Va. State Bar*, 421 U.S. 773, 791 (1975) ("It is not enough that, as the County Bar puts it, anticompetitive conduct is 'prompted' by state action; rather, anticompetitive activities must be compelled by direction of the State acting as a sovereign."). See 1A AREEDA & HOVENKAMP ¶217a, *supra* note 9.

⁸⁷ *Midcal*, *supra* note 22.

⁸⁸ *Goldfarb v. Va. State Bar*, 421 U.S. 773, 791 (1975). The Court spoke in terms of "compulsion" as much as "supervision:"

Here we need not inquire further into the state-action question because it cannot fairly be said that the State of Virginia through its Supreme Court Rules required the anticompetitive activities of either respondent. Respondents have pointed to no Virginia statute requiring their activities; state law simply does not refer to fees, leaving regulation of the profession to the Virginia Supreme Court; although the Supreme Court's ethical codes mention advisory fee schedules they do not direct either respondent to supply them, or require the type of price floor which arose from respondents' activities. Although the State Bar apparently has been granted the power to issue ethical opinions, there is no indication in this record that the Virginia Supreme Court approves the opinions. Respondents' arguments, at most, constitute the contention that their activities complemented the objective of the ethical codes. In our view that is not state action for Sherman Act purposes. It is not enough that, as the County Bar puts it, anticompetitive conduct is 'prompted' by state action; rather, anticompetitive activities must be compelled by direction of the State acting as a sovereign.

⁸⁹ *N.C. Dental*, 135 S.Ct. at 1117.

⁹⁰ *Goldfarb*, 421 U.S. at 790

the relevant state agencies rubber stamped their rate requests with little or no review.⁹¹ It is unclear, however, why rubber stamping by the insurance agency is insufficient, given that it is an agency with the authority to make its own unsupervised substantive decisions in this market. If it exercises by rubber stamping, that would be all the law requires under the dissenters' view.⁹² In *Cantor*, a state agency, the Michigan Public Service Commission, had approved a privately owned electric utility's practice of providing "free" light bulbs to utility customers, later challenged as a tying arrangement.⁹³ Nevertheless, the Supreme Court disapproved the arrangement. In sum, the majority's approach was hardly "unprecedented," as the dissent suggested.⁹⁴ Rather, it was more responsive to the Court's long list of admittedly fumbling and confusing precedents, while the dissent dwelt at length on *Parker*.

Fundamentally, the dispute between the majority and the dissent centered on the questions of "how much federalism" vs. "how much national competition policy." For the dissenters all the state need do is declare that a group of private actors is an "agency" and that is the end of the matter. Apparently, the state could simply create an agency of taxicab drivers, authorize them to select several among their members as decision-makers, and then give them the authority to fix taxicab prices, with no further oversight required. This fact did not appear to trouble the dissenters because the state as sovereign is competent to deal with the matter itself. On this point, the majority's view seems more realistic about legislative processes. For the dissenters all that was required was the formality that the state designate the association as an agency, perhaps decades prior to the challenged action, as was so in this case.⁹⁵

The dissenters' observation that dentistry was traditionally self-regulated⁹⁶ also seems beside the point of the federalism issue, and perhaps even cuts the other way. The Commerce Clause identifies the line between federal governmental and state governmental power, not the line between federal governmental power and private conduct. Entrepreneurial self-regulation implies a division of authority as between the government on one side and private enterprise on the other. Indeed, to the extent that a tradition of self-regulation is relevant it suggests that the states were not involved. This fact should create more room—rather than less—for an expansion of federal power. While federal regulatory power under the Commerce Clause is properly limited by state governmental activity, it is not limited by things that are within Congressional reach and in which the state does not play a part.

For considerations of federalism, the extraterritorial effect or lack of it seems to be much more significant, although the point was ignored by both the majority and the dissent. Ironically, the raisin cartel found to be immune in *Parker* makes a better case for non-immunity than the

⁹¹ *FTC v. Ticor title Ins. Co.*, 504 U.S. 621 (1992).

⁹² Justice Scalia concurred with the Court's finding of nonimmunity in *Ticor*, but warned that the holding would produce "uncertainty and (hence) litigation." *Ticor*, 504 U.S. at 641. He gave the example of private physicians invited to participate in a hospital peer review system and who might not find out until too late that the State's supervision was not "active" enough. *Id.*

⁹³ *Cantor v. Detroit Edison*, 428 U.S. 579, 637 (1976).

⁹⁴ *N.C. Dental*, 135 S.Ct. at 1117.

⁹⁵ The statutes in question creating the dental association as an agency were passed in 1957, and amended in 1961, 1971, 1973, and 1981. See N.C.G.S.A. § 90-22, NC ST § 90-22.

⁹⁶ *N.C. Dental*, 135 S.Ct. at 1118.

dentists' cartel in *North Carolina Dental*. Under the program at issue in *Parker* ten producers of an agricultural commodity could request that the Commissioner create a "prorate" Committee for that product. The Committee was composed of several producers of the commodity, although the Commission had discretion to add two distribution members, such as canners or other handlers.⁹⁷ At that point the producer-dominated committee issued production allocation decisions, and all growers in the covered area were required to comply. Most significantly, in *Parker* nearly all of the raisins produced under the quotas were shipped outside of the state of California, making the state's raisin growers an enormous beneficiary of the cartel while visiting the consumer harm elsewhere.⁹⁸ Whether the non-dominant "distribution" members of the Committee were injured or benefitted would depend on their markup. Ordinarily intermediaries would suffer from an upstream cartel in the distributed product unless they were compensated by affected producers.

By contrast, in *North Carolina Dental* it seems clear that most of those purchasing teeth-whitening services in North Carolina are also residents of that state. Further, states have their own regulatory provisions as well as their own antitrust laws. These can also be deployed against the anticompetitive acts of state professional associations (whether or not they are denominated "agencies") if the state legislatures or courts so choose.⁹⁹

The majority thought that an important use of federal antitrust policy is to force a layer of transparency through more public control of the state's own governmental processes, quite aside from any question about extraterritorial spillovers. The Court emphasized that:

Immunity for state agencies...requires more than a mere facade of state involvement, for it is necessary in light of *Parker*'s rationale to ensure the States accept political accountability for anticompetitive conduct they permit and control.¹⁰⁰

Further, this concern about transparency is important even if the goal is to protect the residents of a state from their state's own anticompetitive decisions. The Court spoke repeatedly of unsupervised private conduct that deviated from the *state's own* interest, stating "Entities purporting to act under state authority might diverge from the State's considered definition of the public good,"¹⁰¹ and that the federal antitrust concern is to identify when the private decision-maker "is acting to further his own interests, rather than the governmental interests of the state."¹⁰² Interestingly, the dissenters did not push this point, even though all three (Justices Alito, Scalia, and Thomas) are strongly sympathetic with concerns of federalism and state self-determination.

The dissent also objected that the majority's identification of "capture" with control by market participants was "crude," and that determining when capture has occurred is "no simple

⁹⁷ *Parker v. Brown*, 317 U.S. 341, 346-347 (1943).

⁹⁸ See HOVENKAMP, *OPENING OF AMERICAN LAW*, *supra*, note 13 at 297-298.

⁹⁹ On state antitrust law, See 14 HERBERT HOVENKAMP, *ANTITRUST LAW*, Ch. 24 (3d ed. 2012).

¹⁰⁰ *N.C.Dental*, 135 S.Ct. at 1111.

¹⁰¹ *Id.* at 1112.

¹⁰² *Id.*

task."¹⁰³ That observation is certainly factually correct, and political history is filled with instances in which even salaried government officials were captured by the entities that they were supposed to be regulating.¹⁰⁴ Perhaps the more pertinent question is whether disciplining the decision-making of self-interested market participants is a worthwhile activity when other decision-makers who are not market participants might act improperly as well.

The best answer is that even imperfect law can be better than no law at all. For example, a policy of removing drunk drivers from the road is worthwhile, even though not every accident is caused by a drunk. Self-interested market participants are highly likely to be compromised in favor of their own industry and may even rationalize that their decisions are best for the public as well. Salaried government officials may or may not be excessively beholden to the industries that they are intended to regulate, but capture cannot simply be presumed, and the political process with its checks and balances provides greater control. This is particularly true of multi-sector government regulators, who face conflicting pressures from competing interest groups.

Finally, the dissent fretted that the rule adopted by the majority would increase the risk of antitrust treble damages exposure to those who serve on state agencies. While that problem seems manageable, it does have to be managed. Damages actions seem to be almost a foregone conclusion. As the majority pointed out, the very objection launched by most dentists to non-dentist teeth whitening, and which provoked the dental association's rule, was that the non-dentists were charging a lower price.¹⁰⁵ This evidence not only creates an inference that higher prices resulted, but also provides a yardstick for measuring the extent of the overcharge.

The most obvious way for state agency officials to avoid antitrust exposure is to ensure that potentially anticompetitive decision-making be supervised by economically disinterested government officials. Another is to ensure that majority control over potentially anticompetitive professional decisions not be vested in market participants. A third is use of the antitrust mechanisms themselves, including the rule of reason for most professional rules that are reasonably intended to promote socially valuable practices, and the *per se* rule for the occasional situation where a professional association oversteps, as occurred in this case.

It is worth noting that standard-setting is ubiquitous in the American economy and is hardly limited to professional organizations. In most cases those setting standards have no immunity, but have simply learned to live within antitrust parameters. The courts, for their part, have learned to appreciate the competitive and other social values of collaborative setting of standards. As a result most, although not all, of such practices survive antitrust scrutiny.¹⁰⁶ Of course, this risk may be acceptable for a market participant but not for a citizen who volunteers as a public service.

¹⁰³ *Id.* at 1123.

¹⁰⁴ E.g., JAMES M. LANDIS, REPORT ON REGULATORY AGENCIES TO THE PRESIDENT ELECT (1960); HOVENKAMP, THE OPENING OF AMERICAN LAW, *supra* note 13 at 308-309.

¹⁰⁵ See 135 S.Ct. at 1108.

¹⁰⁶ See 12 ANTITRUST LAW ¶¶ 2230-2235.

Finally, the majority did not rule out the possibility of simple state court supervision by judges, provided that the review extended to the substance and not merely the procedure.¹⁰⁷ The Court approved a roughly similar process in *Hoover*, concluding that substantive review by the state supreme court, acting in a quasi-legislative capacity as manager, eliminated the need for a separate supervision requirement.¹⁰⁸ By contrast, *Goldfarb* denied immunity after finding that the state's supreme court did not supervise the bar's practices.¹⁰⁹ This adjustment may require a modification of state administrative procedure acts or collateral legislation so as to provide for more substantive judicial review when a threat to competition is apparent. The court may then be empowered to appoint one or more special masters or other experts to evaluate the proposed rule.

The majority concluded that the states could readily indemnify agency members. Of course, indemnification does not remove treble damages but provides that those damages must be paid by the state and its taxpayers rather than the designated citizen officials themselves. That in itself, however, might be a good discipline against anticompetitive conduct.

III. CONCLUSION

How much can a state default on its sovereign obligations and continue to be called sovereign? The standard that the Supreme Court has developed is actually not all that high. The final decision must come from a government decision-maker with power to review and disapprove, but largely under any standard that the state wishes to articulate. What the state cannot do, however, is simply paste the label "sovereign" or "agency" on a purely private actor.

Neither the *North Carolina Dental* majority or dissent expressed much concern about whether the anticompetitive conduct in question was self-detering, and thus more addressable through the state's own political processes. The raisin cartel in *Parker* was an economically rational act for the state of California, because the beneficiaries were within the state while nearly all of the victims were elsewhere. Under *Midcal* a state could, if it wished, articulate a policy of supporting cartels of products in which local producers were dominant in the market but buyers were mainly outside. That policy would increase the state's wealth and might even attain voter support as a revenue device. If the state adequately articulated that policy and final decisions were made by a governmental official, that would be the end of the matter insofar as antitrust is concerned. By contrast, assuming that the teeth-whitening cartel is harmful—and the evidence strongly suggested that it was—the net harm in the *Dental* case was experienced mainly by residents of North Carolina who purchased teeth-whitening services. As a general proposition cartels are socially costly because the aggregate harm to purchasers exceeds the aggregate benefit to cartel members.¹¹⁰

In that case North Carolina's failure to supervise was injuring its own economy, but why shouldn't it have that right? The important qualifier is that the effects of the cartel must be

¹⁰⁷ See *Id.* at 1110 ("State legislation and 'decision[s] of a state supreme court, acting legislatively rather than judicially,' will satisfy this standard...").

¹⁰⁸ *Hoover v. Ronwin*, 466 U.S. 558, 569 (1984).

¹⁰⁹ *Goldfarb v. Va. State Bar*, 421 U.S. 773, 791 (1975).

¹¹⁰ See HERBERT HOVENKAMP, FEDERAL ANTITRUST POLICY: THE LAW OF COMPETITION AND ITS PRACTICE §§4.0-4.2 (5th ed. 2016) (in press).

internalized, with both beneficiaries and the burdened located within the state. Under the two-prong test for the antitrust "state action" immunity this question of internalization is rarely relevant. Federal antitrust law reaches almost everywhere, certainly to a highly commercial profession such as dentistry, notwithstanding that most dentist-patient transactions are intrastate. Further, the two-prong *Midcal* test for state action is well established and does not make the location of antitrust harm relevant. The fact remains, however, that *North Carolina Dental* presents a weaker case for federal intrusion than did *Parker*.

The *Dental* case reflects greater paternalism, protecting North Carolina citizens from their own deficient governmental decisions. Indeed, the majority in the *Dental* case articulated the supervision requirement as querying whether the practice "promotes state policy" rather than the defendant's individual interests.¹¹¹ This recalled the query in the *Phoebe Putney* case into whether a non-sovereign actor has "an incentive to pursue [its] own self-interest under the guise of implementing state policies."¹¹² At the same time, however, the degree of paternalism is relatively modest—no more than necessary to force the state to make its own policy more public to its own citizens.

¹¹¹*N. C. Dental*, 135 S.Ct. at 1112, quoting *Patrick v. Burget*, 486 U.S. 94, 101 (1988).

¹¹²*FTC v. Phoebe Putney Health Sys., Inc.*, 133 S.Ct. 1003, 1011 (2011).