

# Putting the Lid on State-Sanctioned Cartels: Why the State Action Doctrine in its Current Form Should Become a Remnant of the Past

AARON C. STINE\* & ERIC D. GORMAN\*\*

INTRODUCTION .....	123	R
I. UNITED STATES ANTITRUST LAW AND THE STATE ACTION DOCTRINE.....	125	R
II. A CARTEL WITHOUT CONSEQUENCES.....	128	R
III. THE TIME IS NOW: A PROPOSAL FOR REFORM OF THE STATE ACTION DOCTRINE .....	131	R
IV. FEDERALISM CONCERNS.....	135	R
CONCLUSION .....	138	R

*“What the railroads wanted, in other words, was a government-sponsored and enforced cartel in place of the many private ones that kept failing.”<sup>1</sup>*

## INTRODUCTION

It has been called a “supreme evil,”<sup>2</sup> one that impacts a volume of commerce that reaches into the billions of dollars.<sup>3</sup> Moreover, it results in fines totaling hundreds of millions of dollars a year,<sup>4</sup> and carries with it a potential criminal sentence of up to ten years.<sup>5</sup> One might guess, with good reason, that these statements describe conduct such as drug trafficking or the sale of other illegal goods. In fact, however, they describe the behavior of commercial entities participating in cartels, motivated by a desire to maximize profits and minimize competition.

\* J.D., The George Washington University Law School. B.A., International Relations, Michigan State University.

\*\* J.D., The John Marshall Law School. B.S., Mechanical Engineering, Michigan State University. eric.d.gorman@gmail.com.

1. JOHN STEELE GORDON, AN EMPIRE OF WEALTH: THE EPIC HISTORY OF AMERICAN ECONOMIC POWER 238 (2004). This quote demonstrates the mindset of private firms who desire to enter into cartels immune to antitrust scrutiny through a judicially-created antitrust exemption known as the state action doctrine.

2. Verizon Commc’ns Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398, 408 (2004).

3. Gerald F. Masoudi, Deputy Assistant Attorney Gen., Antitrust Div., U.S. Dep’t of Justice, Cartel Enforcement in the United States (And Beyond) 2 (Feb. 16, 2007), available at <http://www.justice.gov/atr/public/speeches/221868.pdf>.

4. See *id.* (“In the fiscal year that ended September 30, 2006, the [Antitrust] Division [of the Department of Justice] . . . obtained total fines of more than \$473 million . . .”).

5. *Id.* at 3.

Knowing that such behavior is normally met with swift and harsh consequences if uncovered, one may be surprised, or more likely dismayed to learn that cartels have sometimes found shelter in the United States under what is known as the state action doctrine.<sup>6</sup> The state action doctrine shields these cartelized firms from antitrust scrutiny, which results in untold amounts of consumer losses in the form of artificially elevated consumer prices.

Active competition is the backbone of United States economic policy, but it can be relentless, prompting firms to avoid competition if at all possible. Normally, competitors will avoid forming a cartel because the risks of getting caught are too great, yet that same fear leads some firms to ponder how they can reap the benefits associated with anticompetitive cartels while avoiding any of the costs. One answer is to seek protection from state governments: “they travel to their capital and, if they are fortunate, are granted succor.”<sup>7</sup> The idea that firms should be shielded from competition under the umbrella of state protection and the state action doctrine has no equivalent counterpart in other highly developed economic zones such as the European Union, and many within the United States have criticized the doctrine for the substantial costs it imposes on consumers. Unfortunately, courts have gone against the grain and issued “varied and controversial interpretations [of the state action doctrine], sometimes resulting in unwarranted expansion of the exemption and the shielding of essentially private anticompetitive conduct.”<sup>8</sup>

This Article argues that not only is it appropriate to rein in expansion of the state action doctrine, but also courts should go one step further and remodel the doctrine to more closely resemble the European Union’s laws on Member State anticompetitive conduct. It is time to prevent special interest groups from soliciting shelter from state legisla-

---

6. This Article will sometimes refer to the state action doctrine simply as the “doctrine.” Further, this Article focuses on how the doctrine can protect cartels from antitrust scrutiny, but it should be noted that the doctrine protects all kinds of anticompetitive conduct (e.g., horizontal market allocation and group boycotts). This Article focuses on cartels merely because they are perhaps the most pernicious and well-known anticompetitive conduct.

7. Deborah Platt Majoras, *State Intervention: A State of Displaced Competition*, 13 *Geo. Mason L. Rev.* 1175, 1178 (2006).

8. *Id.* at 1179; see also Jim Rossi, *Antitrust Process and Vertical Deference: Judicial Review of State Regulatory Inaction*, 93 *Iowa L. Rev.* 185, 208 (2007) (“Without a judicial safeguard, overbroad judicial endorsement of the state-action exception allows anticompetitive private conduct to escape scrutiny altogether and risks undermining the goals of competition law . . . .”); Elizabeth Trujillo, *State Action Antitrust Exemption Collides with Deregulation: Rehabilitating the Foreseeability Doctrine*, 11 *Fordham J. Corp. & Fin. L.* 349, 353 (2006) (“[B]road deference to regulatory policy in addition to broad application of state action . . . favor[s] already established companies in the electricity market, essentially empowering the regulatory agencies and in turn, advancing the interests of the dominant companies which they regulate.”).

tures, thereby deicing the freeze on pro-competitive market behavior caused by the doctrine. Section I of this Article briefly describes United States antitrust law and explores the historical underpinnings and development of the state action doctrine. Section II assesses the dangers and costs associated with the state action doctrine, exemplified by a typical example of how private firms can engage in shielded cartelized behavior under the guise of state regulation. Section III considers how the European Union treats anticompetitive state conduct to provide a framework for overhauling the state action doctrine. Finally, Section IV explores and responds to federalism concerns associated with any potential overhaul of the doctrine.

### I. UNITED STATES ANTITRUST LAW AND THE STATE ACTION DOCTRINE

The inception of United States antitrust law traces back to 1890 when Congress passed the Sherman Antitrust Act of 1890 (“Sherman Act”).<sup>9</sup> Section One of the Sherman Act was designed to prevent cartels and trusts from dominating the American landscape: it declared illegal “[e]very contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States . . . .”<sup>10</sup> For a period of over fifty years, the Sherman Act’s reach was vast; covering both public and private business combinations alike.<sup>11</sup> Its scope, however, was curtailed by the Supreme Court’s decision in *Parker v. Brown*,<sup>12</sup> which marked the inception of the state action doctrine.

In *Parker*, the Supreme Court held that a California regulation was not subject to the Sherman Act because federal antitrust legislation could not preempt state law.<sup>13</sup> The court wrote:

We find nothing in the language of the Sherman Act or in its history which suggests that its purpose was to restrain a state or its officers or agents from activities directed by its legislature. In a dual system of government in which, under the Constitution, the states are sovereign, save only as Congress may constitutionally subtract from their authority, an unexpressed purpose to nullify a state’s control

---

9. Sherman Antitrust Act, ch. 647, 26 Stat. 209 (1890) (codified at 15 U.S.C. §§ 1–7 (2006)).

10. *Id.* § 1.

11. See Dirk C. Phillips, Note, *Putting Parker v. Brown and its Progeny in Perspective: An Assessment of the Supreme Court’s Role in the Development of Antitrust Federalism*, 16 J.L. & POL. 193, 193 (2000).

12. 317 U.S. 341 (1943).

13. The regulation at issue in the case was a raisin marketing program that allowed raisin producers to petition for the establishment of a marketing plan that would effectively restrict competition among the producers and maintain raisin prices. *Id.* at 346.

over its officers and agents is not lightly to be attributed to Congress.<sup>14</sup>

“The *Parker* approach treats a state legislative body as a ‘sovereign,’ presumptively allowing it to regulate private conduct as it sees fit.”<sup>15</sup>

The court in *Parker*, however, did not intend to allow a state to countenance all anticompetitive behavior that would otherwise violate the federal antitrust laws. The court recognized that “state regulation could, in some instances, allow firms to engage in conduct that runs afoul of the Sherman Act.”<sup>16</sup> Thus, the court recognized that “a state does not give immunity to those who violate the Sherman Act by authorizing them to violate it, or by declaring that their action is lawful.”<sup>17</sup> California’s regulation of private raisin producers did not contravene this principle because the legislators had put into place an extensive regulatory apparatus, which included a public-approval process and an enforcement mechanism:

It is the state which has created the machinery for establishing the prorate program. Although the organization of a prorate zone is proposed by producers, and a prorate program, approved by the Commission, must also be approved by referendum of producers, it is the state, acting through the Commission, which adopts the program and which enforces it with penal sanctions, in the execution of a governmental policy.<sup>18</sup>

*Parker* established a general presumption against preemption of state regulation under the Sherman Act, but it left a number of questions unanswered, including what types of state regulation would not be immunized by the newly created doctrine. In other words, the Court left open the question as to when private firms’ conduct would be subject to federal antitrust scrutiny despite being allegedly under the umbrella of state regulation.

Subsequent cases applied the *Parker* state action doctrine, but merely on a case-by-case basis, adding little in the way of a cohesive framework.<sup>19</sup> The definitive answer would come later when the Supreme Court began to question the highly deferential *Parker* approach to state regulation. In 1980, thirty-seven years after *Parker*, the Supreme Court articulated the modern approach towards state regulation of private

---

14. *Id.* at 350–51.

15. Rossi, *supra* note 8, at 193 (footnote omitted).

16. *Id.*

17. *Parker*, 317 U.S. at 351.

18. *Id.* at 352.

19. *See, e.g.*, Goldfarb v. Va. State Bar, 421 U.S. 773 (1975) (holding that fee schedules enforced by a state bar association were not immune from antitrust attack); Cantor v. Detroit Edison Co., 428 U.S. 579 (1976) (holding no antitrust immunity where the state agency passively accepted a public utility’s tariff).

interests in *California Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc.*<sup>20</sup> In *Midcal*, the Supreme Court invalidated a California wine-pricing scheme because California merely served as a conduit for private wine producers to dictate prices charged by wine wholesalers.<sup>21</sup> The Court established a two-prong standard for antitrust immunity under *Parker*: 1) “the challenged restraint must be ‘one clearly articulated and affirmatively expressed as state policy’”; and 2) “the policy must be ‘actively supervised’ by the State itself.”<sup>22</sup>

The California wine-pricing scheme satisfied the first prong because the California legislature had forthrightly stated the scheme’s purpose to permit resale price maintenance, but the scheme failed the second prong.<sup>23</sup> California played too passive of a role in the supervision of wine prices: it “simply authorize[d] price setting and enforce[d] the prices established by private parties.”<sup>24</sup> The Court further chastised California’s role in the process: “The State neither establishe[d] prices nor review[ed] the reasonableness of the price schedules; nor [did] it regulate the terms of fair trade contracts. The State [did] not monitor market conditions or engage in any ‘pointed reexamination’ of the program.”<sup>25</sup> The Court emphasized that the “national policy in favor of competition cannot be thwarted by casting such a gauzy cloak of state involvement over what is essentially a private price-fixing arrangement.”<sup>26</sup>

Although *Midcal* may seem like a high hurdle for antitrust defendants to clear, it has become something of a paper tiger, in large part because courts (including the Supreme Court itself) have chipped away at its application.<sup>27</sup> The “gauzy cloak of state involvement” has not been stripped of its effectiveness, and it continues to hide the dagger wielded by private firms in the form of otherwise illegal price-fixing cartels and other anticompetitive conduct. The dagger inflicts considerable wounds on consumers’ wallets, yet despite these effects, private firm cartels such as the tobacco cartel described in the following Section still function, thereby defying the “national policy in favor of competition.”<sup>28</sup>

---

20. 445 U.S. 97 (1980).

21. *Id.* at 101–102, 105.

22. *Id.* at 105 (quoting *City of Lafayette v. La. Power & Light Co.*, 435 U.S. 389, 410 (1978)).

23. *Midcal*, 445 U.S. at 105.

24. *Id.*

25. *Id.* at 105–06.

26. *Id.* at 106 (emphasis added).

27. For example, in *Hoover v. Ronwin*, the Supreme Court limited *Midcal* to cases “involving the anticompetitive conduct of a nonsovereign state representative.” 466 U.S. 558, 568–69 (1984). Thus, “[w]here the conduct at issue is in fact that of the state legislature,” there is no need to consider the issues of clear articulation or active supervision. *Id.* at 569.

28. *Midcal*, 445 U.S. at 101.

## II. A CARTEL WITHOUT CONSEQUENCES

*“State action immunity drives a large hole in the framework of the nation’s competition laws.”*<sup>29</sup>

The state action doctrine may seem to strike a fair balance between state sovereignty and federal regulation, yet it has come at a steep price. Consumers are invariably worse off economically as cartels use their market power to artificially elevate prices beyond what would exist in a normal competitive environment. By way of illustration, the infamous vitamins cartel, which existed between four market leaders in the production of vitamins A and E from 1989 until February 1999, raised prices for those vitamins up to seventy percent and had drastic effects both in the United States and Europe.<sup>30</sup> These drastic price increases and the accompanying profits incentivize businesses to seek the protection of the states through the state action doctrine, thus avoiding the severe penalties they would incur if their behavior was uncovered by federal anti-trust regulators. To demonstrate the dangers of cartels and the relationship between such dangers and the state action doctrine, this Section discusses the ongoing tobacco cartel that traces its origins to a Master Settlement Agreement (“MSA”) between big tobacco manufacturers and a majority of the states.<sup>31</sup>

Although the vitamins cartel was ultimately discovered and its participants punished, other cartels have prospered without fear of the consequences, all by way of the state action doctrine. Owing its existence to state action immunity, the tobacco cartel is one prominent example. It has thrived as a result of the MSA signed by “46 states, five United States territories, the District of Columbia, and the four major tobacco and cigarette producers” (the Original Participating Manufacturers or

---

29. Joe Sims et al., *The State of Federal Antitrust Enforcement – 2001: Report of the Task Force on the Federal Antitrust Agencies – 2001*, A.B.A. SEC. ANTITRUST L., Jan. 2001, at 42, [http://www.americanbar.org/content/dam/aba/administrative/antitrust\\_law/report\\_antitrustenforcement.authcheckdam.pdf](http://www.americanbar.org/content/dam/aba/administrative/antitrust_law/report_antitrustenforcement.authcheckdam.pdf).

30. See Guy Sagi, *The Oligopolistic Pricing Problem: A Suggested Price Freeze Remedy*, 2008 COLUM. BUS. L. REV. 269, 355–56 (2008). In a study performed by national enforcement agencies, estimates of the cartel overcharges for 14 large multinational cartel cases between the years 1996 and 2000 ranged from 5 to 65 percent, with the median around 15 to 20 percent. See William J. Kolasky, Deputy Assistant Attorney Gen., Antitrust Div., U.S. Dep’t of Justice, *What is Competition? Address Before the Seminar on Convergence in The Hague, Netherlands* 5 (Oct. 28, 2002), available at <http://www.justice.gov/atr/public/speeches/200440.htm>.

31. For additional examples of cartels or cartelized behavior protected by the state action doctrine, see generally Clark C. Havighurst, *Contesting Anticompetitive Actions Taken in the Name of the State: State Action Immunity and Health Care Markets*, 31 J. HEALTH POL. POL’Y & L. 587 (2006) (discussing cartelized behavior in the health care industry); Bobak Razavi, *Harmonizing Antitrust Exemption Law: A Hybrid Approach to State Action and Implied Repeal*, 9 J. BUS. & SEC. L. 1 (2009) (discussing a Wisconsin case involving a local bar cartel).

“OPMs”).<sup>32</sup> The MSA, through a variety of measures that were lobbied for by the cigarette manufacturers, effectively froze competition in the industry and barred new entry, thereby allowing the cigarette manufacturers to maintain market share while gouging consumers.<sup>33</sup> As a result, the MSA has come under fire from some critics who allege that it permits the tobacco companies to act as a “state-sanctioned cartel, passing on to consumers the costs of their estimated \$206 billion damage payment and using the settlement structure to raise cigarette prices even higher.”<sup>34</sup> Other critics have made even more damning accusations, arguing that the “settling tobacco companies used smoking consumers’ money to purchase state permission to collusively increase cigarette prices, while at the same time suppressing competition.”<sup>35</sup>

The MSA has thus been described as a “law made in the course of an end-run around state and federal legislatures,” yet both the MSA and the tobacco companies have evaded judicial castigation.<sup>36</sup> In the most recent challenge, *Sanders v. Brown*, Steve Sanders, the plaintiff, brought suit against the four major tobacco companies and the California Attorney General, alleging that the combination of the MSA, the post-settlement price increases, and the mandatory state statutes implementing the provisions of the MSA demonstrate a “cigarette price-fixing cartel that violates the Sherman Act.”<sup>37</sup> Sanders pointed to evidence that the OPMs raised prices by \$4.50 per carton immediately following enactment of the MSA, and then proceeded to further raise prices by \$7.70 in the next three and a half years, all without any noticeable change in market share.<sup>38</sup> However, the district court granted the defendants’ motion to dismiss, finding that the “*Parker* state-action immunity doctrine shielded

---

32. Robert W. Bauer, Note, *Sanders v. Brown: State-Action Immunity and Judicial Protection of the Master Settlement Agreement*, 34 J. CORP. L. 1291, 1295 (2009). The MSA had two main purposes: 1) the recovery of state funds used to treat tobacco-related illnesses through state Medicaid or state employee health insurance plans; and 2) to enjoin the tobacco companies from producing marketing campaigns that might appeal to underage tobacco users. *Id.*

33. *Id.* at 1295–99.

34. Daniel A. Crane, *Harmful Output in the Antitrust Domain: Lessons from the Tobacco Industry*, 39 GA. L. REV. 321, 332 (2005); see Bauer, *supra* note 32, at 1291–92.

35. Bauer, *supra* note 32, at 1292. Indeed, there is evidence that the tobacco companies knew that the MSA would facilitate the making of a tobacco cartel. Prior to signing the MSA, the OPMs attempted to get blanket antitrust immunity from Congress, but Congress denied them immunity because of the strong Federal Trade Commission opposition. *Id.* at 1301. Thus, “[t]he most plausible explanation is that the tobacco producers’ attempt to secure the antitrust exception evinces a clear knowledge that achieving the goals of the MSA would facilitate, if not compel, anticompetitive activity.” *Id.* at 1301–02.

36. Margaret A. Little, *A Most Dangerous Indiscretion: The Legal, Economic, and Political Legacy of the Government’s Tobacco Litigation*, 33 CONN. L. REV. 1143, 1176 (2001); see also *Sanders v. Lockyer (Sanders I)*, 365 F. Supp. 2d 1093, 1104–05 (N.D. Cal. 2005).

37. *Sanders v. Brown (Sanders II)*, 504 F.3d 903, 906 (9th Cir. 2007).

38. *Sanders I*, 365 F. Supp. 2d at 1097.

the defendants from suit because the statutes administering the provisions of the MSA were produced by sovereign acts that were not subject to federal antitrust law.”<sup>39</sup>

On appeal, the Ninth Circuit affirmed the district court decision and agreed that the *Parker* doctrine shielded the defendants from liability for entering into the MSA as well as any behavior that resulted from its signing.<sup>40</sup> The court considered whether to apply the more exacting *Midcal* standard,<sup>41</sup> but ultimately concluded that *Midcal* was inapplicable because the enabling statutes implementing the MSA were the result of a “sovereign acts.”<sup>42</sup> Instead, the court applied the *Hoover* standard,<sup>43</sup> which protected the MSA and its implementation because both were considered sovereign acts of the state.

The *Sanders* decision has been characterized as plagued with inconsistencies, with the court garnering criticism for shirking its responsibility to apply the state action doctrine in its more rigid form.<sup>44</sup> In particular, the *Sanders* court seemingly stretched the facts to avoid applying the *Midcal* standard: the court held that this was not a case of private parties acting in conjunction with state authorities to impose competitive, yet the facts say differently.<sup>45</sup> As one commentator put it, “it is difficult to conceive of the MSA as anything but private parties imposing competitive restraints in conjunction with state authorities.”<sup>46</sup> The tobacco producers and the state attorneys general cooperated with each other from the beginning, working side by side in secret meetings in Washington and producing a settlement agreement that formed the basis for the implementing statutes.<sup>47</sup> The *Sanders* court even admitted that the attorneys general and tobacco producers together designed the incentive system contained in the agreement to protect the OPMs’ dominant market share.<sup>48</sup> Thus, the court’s analysis suggests that it was straining to find a way to avoid application of *Midcal*, likely because the MSA and its implementing statutes would have failed the second prong under

---

39. Bauer, *supra* note 32, at 1298 (citing *Sanders II*, 504 F.3d at 910).

40. *Sanders II*, 504 F.3d at 916–19.

41. As opposed to the more relaxed standard of *Hoover*. See *Hoover v. Ronwin*, 466 U.S. 558, 568–69 (1984).

42. *Sanders II*, 504 F.3d at 916.

43. *Hoover v. Ronwin*, 466 U.S. 558, 568–69 (1984).

44. See generally Bauer, *supra* note 32, at 1299–1307 (discussing criticisms of the decision).

45. *Sanders II*, 504 F.3d at 916.

46. Bauer, *supra* note 32, at 1306. In fact, the MSA is “the first interstate compact that ‘constitutes both an agreement among the states and a legally binding agreement between the states and a specific group of producers.’” *Id.* (quoting Michael S. Greve, *Compacts, Cartels, and Congressional Consent*, 68 Mo. L. REV. 285, 347 (2003)).

47. Bauer, *supra* note 32, at 1306.

48. *Sanders II*, 504 F.3d at 906–08.



*Midcal*.<sup>49</sup>

The *Sanders* decision demonstrates two primary faults with the state action doctrine. First and foremost, the doctrine can facilitate the creation of a private cartel that is immunized from federal antitrust laws, thereby allowing such a cartel to raise prices without consequences. Second, the doctrine is overly malleable, allowing courts to stretch it to its outer limits to protect state regulation, even if such regulation is being driven in part by private firms.<sup>50</sup> Although the *Sanders* case is somewhat unique in that raised tobacco prices lead to decreased tobacco consumption, a laudable social policy goal,<sup>51</sup> it demonstrates perfectly the implications of allowing state regulations to trump the federal antitrust laws—private firms seeking to form a cartel have an antitrust immunity carrot dangled in front of their face that they would be foolish to pass up.<sup>52</sup> The solution is to overhaul the state action doctrine, incorporating aspects of European Union law on state anticompetitive conduct while also placing the burden on the states to justify anticompetitive economic regulation.

### III. THE TIME IS NOW: A PROPOSAL FOR REFORM OF THE STATE ACTION DOCTRINE

*“Antitrust laws in general, and the Sherman Act in particular, are the Magna Carta of free enterprise. They are as important to the preservation of economic freedom and our free-enterprise system as the Bill of Rights is to the protection of our fundamental personal freedoms.”*<sup>53</sup>

The state action doctrine is antithetical to federal antitrust law because it disrupts the healthy interaction between supply and demand,

---

49. The second circuit applied the *Midcal* standard to address the MSA and found that states failed to “actively supervise” the OPMs pricing provisions: “The states . . . lack oversight or authority over the tobacco manufacturers’ prices and production levels. These decisions are left entirely to the private actors. Nothing in the [MSA] or its [Escrow] Statutes gives the states authority to object if the tobacco companies raise their prices.” *Freedom Holdings, Inc. v. Spitzer*, 357 F.3d 205, 232 (2d Cir. 2004) (citation omitted).

50. See Rossi, *supra* note 8, at 232 (discussing appellate courts’ tendency to avoid strict application of the *Midcal* standard).

51. Note, however, that social goals and antitrust enforcement policy are not meant to be conflated: “Antitrust enforcement is bound by the rule of law. Enforcers or the courts cannot rank antitrust’s multiple social goals based on their ideology, by prosecuting only bad cartels (bid-rigging on milk) versus good cartels (cigarette manufacturers, where a reduction in output may be desirable).” Maurice E. Stucke, *Better Competition Advocacy*, 82 ST. JOHN’S L. REV. 951, 954 (2008).

52. Judicial decisions that adopt a strong deferential approach to state regulation “invite private manipulation of state and local regulators to create antitrust immunity.” Rossi, *supra* note 8, at 208.

53. *United States v. Topco Assocs., Inc.*, 405 U.S. 596, 610 (1972).

instead allowing private firms to join together to set prices unresponsive to the free market. This fact has not been lost upon the European Union, which has enacted competition laws designed to prevent EU members from protecting businesses or particular industries from the rigors of competition. Although commentators in the United States have recognized that the state action doctrine should be limited in scope because state regulations “may have conflicting and not easily discerned motivations—some to control monopoly power or reduce adverse externalities, others to promote cartels for politically favored producers—”<sup>54</sup> few, if any, have proposed a wholesale makeover of the doctrine modeled after the EU.

The EU, with a few particular exceptions, declares Member States’ measures to be subject to the same rules as private firms. The EU declares illegal “all agreements between undertakings . . . which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the internal market.”<sup>55</sup> The EU outlaws cartels by prohibiting any agreements between undertakings that “directly or indirectly fix purchase or selling prices or any other trading conditions.”<sup>56</sup> Contrary to the leeway afforded to private firms by the state action doctrine in the United States, the EU explicitly states that private firms granted favorable rights by Member States are not to be accorded special treatment:

In the case of public undertakings and undertakings to which Member States grant special or exclusive rights, Member States shall neither enact nor maintain in force any measure contrary to the rules contained in the Treaties, in particular to those rules provided for in Article 18 and Articles 101 to 109.<sup>57</sup>

The EU provides a very limited public service exception to this general provision, which exempts undertakings “entrusted with the operation of services of general economic interest” from the competition rules if and only if application of the competition rules would hinder the performance of these undertakings, and the continued existence of the undertakings in question does not burden trade among the Member States.<sup>58</sup>

---

54. Robert P. Inman & Daniel L. Rubinfeld, *Making Sense of the Antitrust State-Action Doctrine: Balancing Political Participation and Economic Efficiency in Regulatory Federalism*, 75 *TEX. L. REV.* 1203, 1250 (1997).

55. Consolidated Version of the Treaty on the Functioning of the European Union art. 101(1), Sept. 5, 2008, 2008 O.J. (C 115) 47 [hereinafter TFEU].

56. TFEU art. 101(1)(a).

57. TFEU art. 106(1). Articles 101 to 109 contain the EU common rules on competition.

58. TFEU art. 106(2). An example of the public service exception is a monopoly granted by a Member State for postal services, provided that the provision of the postal services is on “acceptable economic conditions.” See Mario Siragusa, *Privatization and EC Competition Law*, 19 *FORDHAM INT’L L.J.* 999, 1075–76 (1996) (discussing the identical provisions of a precursor to

By interpreting the public service exception very narrowly and requiring Member States to justify otherwise anticompetitive measures, the EU has been strict in the application of its competition rules to private entities granted monopoly or other special rights.<sup>59</sup> Courts in the EU have, however, treated special rights granted to private firms as justified if they are granted “for a non-economic, public interest reason” such as for consumer or environmental protection.<sup>60</sup> Yet these public interest, non-economic establishments “remain subject to the prohibition against discrimination and, to the extent that this performance comprises activities of an economic nature, fall under the provisions referred to in Article [106].”<sup>61</sup>

The EU’s laws regarding public restraints and private firms granted special protections provide a basic framework for overhauling the state action doctrine in the United States. The new default rule for anticompetitive state conduct would mirror that of the EU: all state regulations or protections afforded to private parties by state action would be subject to the federal antitrust laws to the same extent as other private conduct.

Consistent with the original legislative intent of the Sherman Act, state protections of public interest organizations would continue to enjoy antitrust immunity, provided that such organizations are engaged in non-economic activities. As Senator Sherman himself said, “[The Sherman Act] does not interfere in the slightest degree with voluntary associations made to affect public opinion . . . . They are not business combinations. They do not deal with contracts, agreements, etc.”<sup>62</sup>

Finally, for state regulations that concern economic activities,<sup>63</sup>

---

the TFEU). In its entirety, The Treaty on the Functioning of the European Union Article 106(2) states:

Undertakings entrusted with the operation of services of general economic interest or having the character of a revenue-producing monopoly shall be subject to the rules contained in the Treaties, in particular to the rules on competition, in so far as the application of such rules does not obstruct the performance, in law or in fact, of the particular tasks assigned to them. The development of trade must not be affected to such an extent as would be contrary to the interests of the Union.

TFEU art. 106(2).

59. See generally Siragusa, *supra* note 58, at 1074–78 (discussing application of the public service defense in a variety of cases); Dana L. Romaniuk, Note, *Regulating Public Monopolies in Furtherance of the EEC Free Competition Goal: Article 90 and the Two-Step Approach*, 69 CHL.-KENT L. REV. 1025, 1034–40 (1994) (discussing the same in an identical precursor to the TFEU).

60. Romaniuk, *supra* note 59, at 1036. This is distinct from that of the public service exception described previously, which justifies some anticompetitive *economic* measures.

61. Case 155/73, *Sacchi v. Tele Bielle*, 1974 E.C.R. 409, 428–29.

62. 21 CONG. REC. 2562 (1890) (remarks of Sen. John Sherman).

63. This category could be further limited in scope to state regulation of economic activities that favors one or more particular private interests to ease the fears of those described in Part IV *infra*. For state regulation of other economic activities (e.g., the number of hours a class of persons may work), a less exacting standard could be employed, such as rational basis review, which

states would retain the ability to grant special rights to private firms or otherwise pass anticompetitive state regulation, but only on limited grounds. The standard could be similar to the analysis currently employed by courts in reviewing the infringement of an individual's fundamental, constitutional rights. First, the state must justify the anticompetitive conduct by demonstrating a compelling governmental interest, which is understood as referring to something necessary or crucial.<sup>64</sup> Second, the anticompetitive conduct must be narrowly tailored to achieve the compelling governmental interest.<sup>65</sup> In other words, there cannot be a less anticompetitive means to effectively achieve the compelling government interest.<sup>66</sup> The burden would be on the states to prove all of the above, and it would be difficult for a state to do so, in the same way that it is difficult for an EU Member State to defend anticompetitive measures.<sup>67</sup>

Adopting this new version of the state action doctrine would likely limit or even extinguish antitrust immunity for private cartel participants. Consider, for example, the implementation of the MSA and the effective creation of the tobacco cartel described previously. Under the new standard, the reviewing court<sup>68</sup> would consider whether the states' asserted interest in passing the MSA—to recover state funds and prevent

---

merely asks whether a governmental action is a reasonable means to an end that may be legitimately pursued by the government. *See generally* *United States v. Carolene Prods. Co.*, 304 U.S. 144, 152–54 (1938) (describing rational basis review). The main point is that the state action doctrine in its current form protects private anticompetitive conduct far too often without sufficient safeguards, and thus, there is a need for a strict standard to review state regulation that protects private anticompetitive conduct. For a different variation, *see* Herbert Hovenkamp, *Federalism and Antitrust Reform*, 40 U.S.F. L. REV. 627, 632–33 (2006) (“[I]f a state . . . government really authorizes and effectively supervises a private restraint, so be it. Federal antitrust cannot intervene simply because federal tribunals believe that the regulation in question is ill-advised, inefficient, or a manifestation of interest group capture. However, antitrust need not countenance restraints in which the effective decision makers are the market participants themselves.”).

64. *See* Adam Winkler, *Fatal in Theory and Strict in Fact: An Empirical Analysis of Strict Scrutiny in the Federal Courts*, 59 VAND. L. REV. 793, 800 (2006). An example of a potential compelling governmental interest is consumer protection or traditional public interest justifications, such as health and safety. *See, e.g., Carolene Prods.*, 304 U.S. 144.

65. *See* Winkler, *supra* note 64, at 800.

66. *Id.*

67. For another view, *see* *Cantor v. Detroit Edison Co.*, 428 U.S. 579, 610–11 (1976) (Blackmun, J., concurring) (proposing a similar, albeit less stringent, test as the aforementioned proposal). Blackmun advocates a rule of reason approach, in which a court would look to the reasons behind the state regulation in question and then engage in an analysis to determine whether a scheme's potential harms outweigh its benefits. *Id.*

68. This analysis presumes that the court found the tobacco cartel's behavior, in allegedly fixing prices, to be a per se violation of the Sherman Act, which it most likely was. *See* Bauer, *supra* note 32, at 1301 (“The anticompetitive conduct facilitated by the MSA was almost certainly contemplated to be a per se violation of the federal antitrust laws.”).

marketing to underage consumers<sup>69</sup>—is compelling enough to justify the implementation of the MSA and the tobacco cartel it formed and subsequently immunized. Assuming the states' interest is regarded as compelling—a debatable proposition<sup>70</sup>—the court would surely take issue with the particulars of the MSA scheme because, although the MSA required the tobacco companies to pay the states billions of dollars each year,<sup>71</sup> it allowed the tobacco companies to form a cartel and pass the costs of the settlement onto ultimate consumers.<sup>72</sup>

It is difficult to believe that the states could not have devised an alternative scheme that would have preserved competition among the big tobacco firms while still accomplishing the states' goals. For example, the states could have settled for a lump sum payment that would have taken into account projected health care costs associated with smoking for a number of years, with additional stipulations restricting the tobacco manufacturers from marketing towards underage children. Thus, the tobacco cartel would not have been immunized from antitrust scrutiny because the MSA, as implemented, would fail the second prong of the reformed state action doctrine: the MSA was not narrowly tailored to achieve the state governments' compelling interests.

State-sanctioned cartels and other state anticompetitive conduct are serious issues and are recognized as such by the EU, which has taken proactive steps to confront the problem. The United States should follow in the EU's footsteps and impose a higher burden on the states to justify their conduct. Further, concerns regarding the impact of an overhaul of the state action doctrine on the balance of power between the states and the federal government, although important to recognize, should not prevent any such overhaul as demonstrated in the following Section.

#### IV. FEDERALISM CONCERNS

*“[C]oncerns for federalism do not require the federal antitrust tribunal simply to cave in to purely private business discretion.”<sup>73</sup>*

It is little wonder why the state action doctrine has survived this

---

69. See Bauer, *supra* note 32, at 1295.

70. There are a number of cases where a state has presented what, on its face, could be considered a compelling interest, yet the Court has found otherwise. See, e.g., *Skinner v. Oklahoma ex rel. Williamson*, 316 U.S. 535 (1942) (finding state's police power cannot substantiate prohibition against procreation of criminals); *Roe v. Wade*, 410 U.S. 113 (1973) (finding state's interest in ensuring the health of a pregnant woman prior to end of first trimester not compelling enough to validate statute preventing all abortions save for those necessary to save mother's life); *Lawrence v. Texas*, 539 U.S. 558 (2003) (finding state's interest in promoting morality deemed insufficient to justify statute criminalizing sodomy).

71. See Bauer, *supra* note 32, at 1295.

72. See Section II *infra*.

73. Hovenkamp, *supra* note 63, at 648–49.

long as it is grounded in the notion that the federal government should give “[d]eference to considered state economic choices.”<sup>74</sup> In other words, antitrust law must give way to federalism concerns<sup>75</sup> for it is “the foundation of our constitution” that any action by the central government that invades state sovereignty should be “‘an intrusion justified by some necessity, and as the exception rather than the rule.’”<sup>76</sup> Supporters of the state action doctrine insist that the doctrine is necessary to ensure that “the states’ constitutional powers to regulate commerce are not entirely destroyed, as during the *Lochner* era.”<sup>77</sup> Defenders of the doctrine see judicial review of state laws “for efficiency, rent-seeking, or public-interest goals as tantamount to federal courts returning to substantive-due-process review of state and local regulation, encroaching on decentralized lawmaking in the economic-regulation context.”<sup>78</sup> There are even those who favor exempting all regulatory actions<sup>79</sup> by state governments from judicial review under federal antitrust laws.<sup>80</sup>

The state action doctrine, however, falls well short of meeting its federalism objectives. For one, if the doctrine is best described as a means to enhance “political participation in the formulation of regulatory policies,” then its utility is relatively small. As Professor Elhauge explains, current political institutions are poorly designed to ensure citizen participation in policymaking, and in general, citizens pay little attention to individual policy decisions.<sup>81</sup> Further, the fact that there has not occurred a “groundswell of popular participation in regulatory pol-

---

74. William H. Page, *Antitrust, Federalism, and the Regulatory Process: A Reconstruction and Critique of the State Action Exemption After Midcal Aluminum*, 61 B.U. L. REV. 1099, 1107 (1981).

75. The goals of federalism are multitudinous, ranging from ensuring citizens’ political participation in policymaking to protecting spheres of state sovereignty to enhancing or maintaining economic efficiency. See generally Inman & Rubinfeld, *supra* note 54, at 1209–50 (discussing the goals of federalism). Each of these will be discussed herein.

76. See Phillips, *supra* note 11, at 196–97 (quoting HERBERT WECHSLER, *The Political Safeguards of Federalism*, in PRINCIPLES, POLITICS, AND FUNDAMENTAL LAW 49 (1961)).

77. Peter Hettich, *Mere Refinement of the State Action Doctrine Will Not Work*, 5 DEPAUL BUS. & COMM. L.J. 105, 142 (2006). In *Lochner v. New York*, 198 U.S. 45 (1905), the Supreme Court invalidated a New York law restricting the number of hours that a baker could work on both a daily and weekly basis. The case has been heavily criticized for usurping state legislative authority over economic activities that invoke public safety or welfare concerns. See, e.g., Edwin Meese III, *A Return to Constitutional Interpretation from Judicial Law-Making*, 40 N.Y.L. SCH. L. REV. 925, 927 (1996).

78. Rossi, *supra* note 8, at 209.

79. When referred to in this Article, the terms “regulatory actions” or “regulations” are meant to encompass state legislation and any other types of policymaking functions as well.

80. See Rossi, *supra* note 8, at 210. Those holding this viewpoint do, however, acknowledge that delegations of the power to restrain the market to private parties should remain subject to the Sherman Act. *Id.*

81. See Einer Richard Elhauge, *The Scope of Antitrust Process*, 104 HARV. L. REV. 668, 678–79 (1991).

icy” belies the court’s belief in *Midcal* that its approach to analyzing anticompetitive state conduct would maximize political participation.<sup>82</sup> If there is a federalism justification to preserving the state action doctrine in its current form, it lies not with increasing political participation.

The presence of spillover effects<sup>83</sup> that reduce economic efficiency at the national level present another rationale for why concerns for federalism should not obscure the need for an overhaul of the state action doctrine. In general, states are self-interested, which means they develop economic policies without taking into account (or perhaps willfully ignoring) the policy’s extraterritorial effects.<sup>84</sup> For example, in *Parker*, California’s scheme to prop up its in-state raisin industry had an enormous impact outside of the state: almost all raisins consumed in the United States were produced in California and somewhere between ninety and ninety-five percent of all raisins grown in California were shipped in interstate or foreign commerce.<sup>85</sup> This spillover effect has been recognized by both government agencies and commentators alike<sup>86</sup> as a significant issue; one that the state action doctrine in its current form glosses over or even promotes. There is thus a growing belief that concerns over federalism do not justify maintaining the doctrine’s current status quo;<sup>87</sup> rather, the doctrine is in dire need of an overhaul because of its impact on economic efficiency.

Finally, concerns over state sovereignty that might attach if a state is confronted with the burden of justifying its anticompetitive conduct merit a twofold response. First, the proposed reform does not entirely strip the state and its constituent parts of their sovereign right to regulate economic activities. Rather, it addresses the situation where a state’s anticompetitive economic regulation benefits a discrete class of private interests (e.g., the MSA). These types of regulation carry a heightened

---

82. See Inman & Rubinfeld, *supra* note 54, at 1264.

83. Spillover effects, also known as “negative externalities,” are the “costs absorbed by the citizens of other states when any one state imposes an anticompetitive regulatory scheme.” See FED. TRADE COMM’N OFFICE OF POLICY PLANNING, REPORT OF THE STATE ACTION TASK FORCE 40 (2003), available at <http://www.ftc.gov/os/2003/09/stateactionreport.pdf> [hereinafter “TASK FORCE REPORT”].

84. *Id.* at 41 (“[W]hen anticompetitive state regulations tend to produce in-state benefits but out-of-state harms, states have incentives to over-regulate in ways that reduce welfare for the nation as a whole.”).

85. See *Parker v. Brown*, 317 U.S. 341, 345 (1943).

86. See TASK FORCE REPORT, *supra* note 83, at 40–44 (discussing both private commentators and the FTC’s views on interstate spillovers).

87. See Memorandum from Antitrust Modernization Comm’n to All Comm’rs 25 (June 5, 2006), [http://govinfo.library.unt.edu/amc/pdf/meetings/IE\\_stateact\\_discmemo060605circ.pdf](http://govinfo.library.unt.edu/amc/pdf/meetings/IE_stateact_discmemo060605circ.pdf) (“Federalism and state sovereignty do not justify the state action doctrine where the costs of the anticompetitive conduct are borne primarily by citizens of other states . . .”).

risk of regulatory capture<sup>88</sup> and warrant additional judicial scrutiny.<sup>89</sup>

Second, the trend in the Supreme Court (outside the context of anti-trust law) has been to broaden federal economic regulatory powers at the expense of the states.<sup>90</sup> In its landmark 1985 decision *Garcia v. San Antonio Metropolitan Transit Authority*,<sup>91</sup> the Court held that “[s]tate sovereign interests . . . are more properly protected by procedural safeguards inherent in the structure of the federal system than by judicially created limitations on federal power.”<sup>92</sup> If *Parker* and the inception of the state action doctrine are best understood as a byproduct of the prevailing trend in constitutional law existing at the time—that of deference to the states<sup>93</sup>—then it is entirely appropriate to reevaluate and retool the doctrine in light of the modern trend towards broadening the reach of federal economic powers.<sup>94</sup>

#### CONCLUSION

The state action doctrine is a blunt instrument used by states to distort competition and by private interests to engage in illegal cartelized

---

88. See Rossi, *supra* note 8, at 198 (“[A]t the state and local level, extreme interest groups are more likely to wield influence, while at the national level extremist groups are more likely to cancel each other out.”); see also John Shepard Wiley Jr., *A Capture Theory of Antitrust Federalism*, 99 HARV. L. REV. 713, 714–15 (1986) (criticizing the state action doctrine because state regulation frequently involves “the capture of lawmaking bodies by producer groups seeking benefit at the expense of others”).

89. The FTC recognized a need for additional protections against regulations benefitting insular private interests and suggested that when a state regulatory agency approves a particular instance of rate bureaus or other forms of price fixing, it should issue a written opinion on the merits explaining its decision and the factual findings supporting that decision. See TASK FORCE REPORT, *supra* note 83, at 55. These “reasoned elaborations [would] serve to provide transparency to the process and help ensure that agency decisions do not reflect simply private interest capture.” Hovenkamp, *supra* note 63, at 643.

90. Much of the expansion of federal economic power came under the rubric of the Commerce Clause, U.S. CONST. art. I, § 8, cl. 3. Examples of cases where the Supreme Court took a broad view of interstate commerce include: *Heart of Atlanta Motel v. United States*, 379 U.S. 241 (1964); *Daniel v. Paul*, 395 U.S. 298 (1969); *Perez v. United States*, 402 U.S. 146 (1971); *Hodel v. Va. Surface Mining & Reclamation Ass’n, Inc.*, 452 U.S. 264 (1981). The Court did, however, limit the definition of interstate commerce in two relatively recent cases—*United States v. Lopez*, 514 U.S. 549 (1995), and *United States v. Morrison*, 529 U.S. 598 (2000)—yet those cases are unlikely to be the start of a trend limiting federal power in light of the Court’s decision in *Gonzales v. Raich*, 545 U.S. 1 (2005).

91. 469 U.S. 528 (1985).

92. *Id.* at 552.

93. See Phillips, *supra* note 11, at 209–212 (describing political and constitutional climate preceding and proceeding *Parker*).

94. One could also make the argument that the high degree of deference accorded to the states by courts make little sense when foreign countries receive less deference under federal antitrust laws. For example, in *Hartford Fire Insurance Co. v. California*, 509 U.S. 764, 798–99 (1993), the Supreme Court held that principles of comity did not prevent the Court from exercising jurisdiction over foreign defendants, despite the fact that the alleged illegal conduct on the part of the defendants was perfectly consistent with British law and policy.



behavior without the threat of successful prosecution. As the tobacco cartel created by the MSA and its subsequent state-by-state implementation demonstrates, consumers should be leery of anticompetitive state regulation for “[i]t is [ ] the governments themselves which cause damage to consumers and reduce overall economic welfare due to distortions and restraints of competition resulting from their laws, regulations or concrete administrative practice.”<sup>95</sup> Overcoming the harmful effects of the state action doctrine requires an overhaul of the doctrine modeled after the EU, which would establish the presumption that all state anticompetitive conduct is within the reach of federal antitrust law. The state would bear the burden of proving otherwise, either by demonstrating that the law in question regulates organizations engaged in non-economic activities, or that any law that benefits private interests is narrowly tailored to achieve a compelling state governmental interest.

Requiring states to bear a higher burden in justifying their anticompetitive conduct certainly invokes federalism issues, yet a modernized form of the state action doctrine would make great leaps in promoting economic efficiency while leaving some room for the states to regulate. The doctrine in its current form does little to promote citizen’s political participation in policymaking—an important federalism objective—and reformation of the doctrine would comport with the Supreme Court’s current trend towards broadening federal economic powers. Federalism concerns merit mention in any discussion of revamping the state action doctrine, but they should not be determinative of the issue.

If left unchecked, cartelized behavior under the cloak of state immunity will continue to multiply, a result which the state action doctrine in its current form is ill-suited to prevent. It is time to remold the doctrine, thereby restoring the reputation of federal antitrust law as the Magna Carta of free enterprise and preventing state regulation from trumping federal antitrust law where inappropriate. It is time to make the state action doctrine, as currently constituted, a thing of the past, so that we may look to a future where consumers are not harmed by state-sanctioned cartels or other anticompetitive state conduct.

---

95. Dr. Ulf Böge, President of the Bundeskartellamt, Speech before the Seoul Competition Forum 2004: State-Imposed Restrictions of Competition and Competition Advocacy (April 20, 2004), available at [http://www.bundeskartellamt.de/wEnglisch/download/pdf/04Seoul\\_e.PDF](http://www.bundeskartellamt.de/wEnglisch/download/pdf/04Seoul_e.PDF).

