ANTITRUST

REINING IN ANTITRUST IMMUNITY

In a new case from North Carolina, the Supreme Court may limit Parker *immunity.*

BY TIMOTHY SANDEFUR

In his book *The Antitrust Religion*, Edwin Rockefeller describes antitrust law as a series of "political decisions misleadingly portrayed as law and economics." Nowhere is this more true than in the realm of antitrust *immunity*—the hodgepodge of exemptions, created almost entirely by judges rather than Congress, that excuse "anticompetitive conduct" that would ordinarily be subject to civil and criminal prosecution. Most notable among these is *Parker* immunity, named for the U.S. Supreme Court's 1942 decision in *Parker v. Brown.* That decision allows state governments to illegalize competition or establish cartels practically at will, even though those same actions would be illegal if done by private parties themselves.

In the years since *Parker*, courts have expanded its immunity doctrine so much that states now wield almost limitless power to hand out exemptions to federal antitrust laws that are supposed to set the baseline for national economic policy. The Supreme Court is now poised to decide an important case that could rein in the excessive breadth of *Parker* immunity and limit the power states now enjoy of barring competition through licensing laws and other regulatory barriers. The Court should take this opportunity to rationalize a system of arbitrary exemptions that enables the worst offenders to escape legal constraints that apply to everybody else.

The case involves the North Carolina Board of Dental Examiners, a commission of eight officials who regulate the practice of dentistry in the state. Board members are elected by the state's licensed dentists and dental hygienists. In other words, the people who control entry into the dental services industry are not government officials, but private practitioners in that industry, and they answer to industry incumbents, not to consumers.

About a decade ago, the board began receiving complaints from dentists about the growing practice of "teeth-whitening," a cosmetic procedure in which a plastic strip treated with peroxide is placed on the teeth for a few minutes in order to make them brighter. The complaints were not that teeth-whitening endangers public health; the practice is perfectly safe and can be done at home with a kit available over the counter at the grocery store. Many people choose to have it done while visiting a nail salon or shopping at the mall. But despite the fact that teeth-whitening is a safe, simple, routine procedure, licensed dentists have labored to exclude anyone but themselves from offering the service. It is now against the law in at least 14 states to apply a teeth-whitening strip to someone else's teeth without getting a license, which means meeting expensive and time-consuming education and testing requirements. Responding to its constituents' complaints, the North Carolina Board issued 47 cease-and-desist orders to small business owners who offered "teeth-whitening" in stores and malls throughout the state and urged the state's Board of Cosmetic Art Examiners to bar licensed cosmetologists from offering teeth-whitening services.

When it learned of the board's efforts to block competition for teeth-whitening, the Federal Trade Commission initiated an unlawful competition proceeding against the board. In response, the board claimed that, being a state agency, it enjoyed *Parker* immunity and could not be charged with violating federal antitrust laws. But the FTC rejected that argument and the Fourth Circuit Court of Appeals later agreed. *Parker* immunity, the court held, could not exempt a state agency made up entirely of licensees who stand to benefit personally from restricting competition—an obvious conflict of interest—and who are not actively supervised by public officials. The Supreme Court agreed to take the case, and will hear oral arguments in October.

TIMOTHY SANDEFUR is a principal attorney with the Pacific Legal Foundation and author of *The Right to Earn a Living* (Cato Institute, 2010). He filed a brief on behalf of the Foundation and the Cato Institute in *North Carolina Board of Dental Examiners v. FTC*.

ISTOCK

HOW *PARKER* IMMUNITY WORKS

The Supreme Court's decision in *Parker* was mainly concerned with federalism, not economic considerations. Issued during the New Deal—when state and federal governments were establishing cartels in a wide variety of industries and allowing existing firms to dictate codes of production, set prices, and bar new competitors from entering the market—the *Parker* case concerned a California law regulating raisin producers. That law, the Court acknowledged, was designed "to restrict competition" by allowing a majority of the raisin growers to decide how many raisins to produce and what prices to charge—and to impose crippling fines on any grower who produced more or charged less than the cartel allowed. This byzantine statute remains in place more than 70 years later; during oral arguments in a recent Supreme Court case involving the same scheme, Justice Elena Kagan called it "the world's most outdated law" and Justice Antonin Scalia agreed that it is "a crazy statute."

But in 1941, when raisin packer Porter Brown wanted to buy more raisins than the cartel permitted, that craziness struck him in the pocketbook. He had contracted to sell more raisins than allowed, and when he was charged with violating the law, he filed suit arguing that the restriction violated the Sherman Antitrust Act's prohibition on restraints of trade.

The Supreme Court ruled against him, declaring that private parties who act under the state's aegis are not subject to antimonopoly laws. Although it acknowledged that the raisin cartel "would violate the Sherman Act if it were organized and made effective solely by virtue of a contract, combination, or conspiracy of private persons," it held that where state law establishes the anticompetitive scheme, the Sherman Act would not apply. To hold otherwise would be to interfere with state sovereignty and undermine the "dual system of government" established by the Constitution. Admitting that its decision was "derived not from the literal meaning" but from the "purpose, the subject matter, the context, and the legislative history," of the Sherman Act, the Court concluded that the law had not been intended to "restrain a state or its officers or agents from activities directed by its legislature."

Although couched in the modest language of judicial restraint, the *Parker* immunity doctrine was an extreme innovation in both antitrust law and federalism jurisprudence. It ran contrary to the rationale typically advanced for antitrust laws: if the Sherman Act was designed to foster competition and break down monopolies

(as the Court has often said), then it makes no sense to exempt such quintessentially anticompetitive activity as a cartel protected against competition by state law. Indeed, as Chief Justice Warren Burger remarked in a 1978 case, if the antitrust laws were "meant to deal comprehensively and effectively with the evils resulting from contracts, combinations, and conspiracies in restraint of trade," then it is "remarkable" to treat state-established restraints of trade as "beyond the purview of federal law." At least in ordinary markets, monopolies can exist *only* when propped up by law—yet under *Parker*, the very entities best suited to violate the law were now immune from it.

But the *Parker* Court's conception of federalism was also bizarre: the case appeared to allow states to exempt private parties from federal law simply by passing a law to that effect. In virtually no other context can states immunize their citizens from the operation of federal statutes, let alone permit them to act in ways that are otherwise plainly illegal. Yet although the *Parker* Court insisted 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," that appeared to be just what the Court was allowing the state to do.

Parker is one of several odd immunities that riddle the world of antitrust law. For example, under the *Noerr-Pennington* doctrine (named for two precedents in the 1960s), private parties are immune from prosecution when they advocate for the adoption of laws that would create cartels or monopolies. The Court rightly held that such advocacy is protected political speech under the First Amendment, yet it is also an obvious instance of conspiracy to monopolize, otherwise prohibited by the Sherman Act. And when the Court ruled in the 1980s that local governments could be sued under the antitrust laws, Congress swiftly responded by passing the Local Government Antitrust Immunity Act, shielding even city officials when they take steps to block competition.

These immunities are hard to reconcile with any coherent theory of antitrust law. If anticompetitive conduct is bad because it restricts the availability of goods and services, raises prices for consumers, and makes it more difficult for entrepreneurs to enter an industry, it is senseless to allow government—which is better equipped than any other entity to inflict these harms—to do so with impunity. On the other hand, if the Constitution protects the right to advocate for the establishment of a monopoly, or if the need for broad discretion by decisionmakers to respond to public demands justifies exemption from the antimonopoly laws, then such immunities should apply to everyone, and not only in the limited situations provided for in current law. As Chief Justice Burger observed, antitrust immunity doctrines like these "inject a wholly arbitrary variable into a 'fundamental national economic policy.'"

LIMITS ON *PARKER* IMMUNITY

Such arbitrariness is the inevitable result of trying to fit a set of exemptions based on federalism and other political considerations into a body of antitrust law that focuses on economic concerns and that purports to set trade rules for the whole country. In the years since *Parker*, the Court has struggled to reconcile those incongruent factors and the result has been an erosion of limits on state power.

Parker insisted that it would not allow states *carte blanche* to hand out waivers of federal law. In later cases, the Court reiterated its concern that when a private party engages in anticompetitive activity under the color of state law, "there is a real danger that he is acting to further his own interests, rather than the governmental interests of the State." But a series of decisions beginning largely in the 1980s diluted the limits on immunity to such a degree that states are now almost wholly at liberty to establish cartels and monopolies without federal interference. As law professor E. Thomas Sullivan writes, "The ideology of federalism has displaced a national model of competition for one favoring state-based resolutions."

Active government supervision / The most notable limit on *Parker* immunity is the "active supervision" requirement, under which states may only exempt private parties from the antitrust laws if state officials oversee their acts to prevent them from using their powers for self-interested purposes. This requirement is meant to ensure that states do not "thwart[]" the "national policy in favor of competition" by "casting ... a gauzy cloak of state involvement" over the self-interested cartel behavior of private actors.

But the active supervision requirement has often been honored more in the breach than the observance. Courts have sometimes found the supervision requirement satisfied in cases where elected officials exercised only minimal oversight and have even eliminated the requirement entirely in cases involving private entities that act as quasi-government entities. That category is so amorphous that, as law professor Peter Hettich has written, it "does not provide guidance with regard to the scope of entities needing supervision and to the extent such supervision has to be applied; there is no uniform standard."

The North Carolina Board of Dental Examiners has argued that, as a state agency, it can be presumed to act for the public welfare and therefore should not have to comply with the active supervision requirement—notwithstanding the fact that its members are licensed practitioners who stand to benefit from limiting competition and are elected by others who share that interest. The Fourth Circuit Court of Appeals rejected that argument last March when it held that a state agency staffed by private market participants "chosen by and accountable to their fellow market participants" are not government agents but private actors who must therefore be actively supervised by state officials in order to enjoy antitrust immunity. But a brief filed by West Virginia and 22 other states urges the Supreme Court to overrule that decision on the grounds that "subjecting the States' supervisory choices to such invasive federal oversight plainly trenches upon the States' authority." State governments, they argue, should be

free to decide for themselves what kind of "supervision" is enough to prevent private individuals from abusing government power to block their own competition. This is a clear invitation to abuse. As law professors Aaron Edlin and Rebecca Haw observe, "That the consortium of competitors is called a state board and given power by the state to regulate its profession does not make it more trustworthy. The grant simply makes the board more powerful and therefore more dangerous."

State law requirement / Until the 1980s, a second limit on *Parker* antitrust immunity provided that private parties could be rendered immune only if their anticompetitive conduct was actually *mandated* by state law. Mere "authorization, approval, encouragement, or participation in restrictive private conduct confers no antitrust immunity," the Court declared; instead, states could shield private parties from antitrust immunity only by commanding them to act in anticompetitive ways. Thus in *Goldfarb v. Virginia State Bar* (1975), the justices ruled that the state and county bar associations—private entities—were not immune when they adopted a minimum-price rule that violated the Sherman Act's prohibition on price fixing. The first question to ask when deciding whether to apply *Parker* immunity, the Court said, was "whether the activity is required by the State acting as sovereign." While Virginia appeared to allow such price fixing, "it is not enough that ... anticompetitive conduct is prompted by state action." Instead, anticompetitive acts "must be compelled by direction of the State acting as a sovereign" in order to escape the reach of antitrust laws.

That requirement has since been scaled back. Ten years after *Goldfarb*, the Court decided in *Southern Motor Carriers Rate Conference v. United States* (1985) that state compulsion was not a prerequisite for the availability of *Parker* immunity, and that private actors who engage in anticompetitive conduct can escape antitrust limits whenever their actions are *authorized*, rather than *required*, by state law. That case involved a cartel of moving companies that engaged in price collusion under state laws that permitted such behavior, but did not compel it. When federal officials sued, the Court ruled that *Parker* immunity applied and it eliminated the strict *Goldfarb* rule. Requiring that states actually *mandate* anticompetitive conduct in order to confer antitrust immunity, wrote Justice Lewis Powell, would "reduce[] the range of regulatory alternatives available to the State[s]," and "may result in *greater* restraints on trade."

Powell's argument ignored the fact that federal laws are often *intended* to "reduce the range of regulatory alternatives" left to states, particularly when those federal laws announce national commercial policy, as the antitrust laws purport to do. Worse, the permissive *Southern Motor Carriers* rule reduced political accountability by enabling state officials to pass vaguely worded "permissive" statutes that leave private parties free to decide for themselves whether to block economic competition. While Powell thought the "compulsion" requirement could lead to more restraints on trade, the new "authorization" rule actually allowed states to camouflage their anticompetitive policies and delegate such decisions to private parties not visible or accountable to voters. The *Southern Motor Carriers* rule empowers states to authorize violations of federal law by a mere *pro forma* declaration—precisely what *Parker* had declared impermissible when it held that states could not "give immunity to those who violate the Sherman Act by authorizing them to violate it." S*outhern Motor Carriers*' expansion of immunity was far too generous and ought to be scaled back.

SCALING BACK *PARKER* IMMUNITY

Whatever one's opinion of antitrust law in general, the liberal granting of immunity to government entities, which are in a unique position to inflict anticompetitive harms, is irrational and dangerous. State-imposed cartels cause not only the economic harms on which antitrust law is supposed to focus, but constitutional injuries as well. The Fourteenth Amendment protects every person's right to earn a living free from unreasonable government interference. Yet state licensing laws and other restrictions on trade frequently bar entrepreneurs from entering industries simply to protect established firms against economic competition. Such laws often even deputize incumbent firms in restricting the marketplace against new entrants. That is quintessentially anticompetitive conduct, which any rational antitrust policy would condemn.

To cite only one example, Kentucky's Certificate of Necessity law prohibited any person from entering the moving trade without first notifying the state's existing moving firms and allowing them to object. Such an objection served as a virtual veto on an application. Between 2007 and 2012, 39 people applied for permission to operate moving companies; existing companies collectively filed 114 protests against those applications. None of the protests identified any concerns relating to an applicant's safety, honesty, or consumer service record; instead, the protesting firms all acknowledged that their only reason for objecting was that they did not want competition. Yet during those years, the state denied certificates in every case in which an objection was filed, even where the applicants were highly experienced and fully qualified. In February, a federal court declared that licensing law unconstitutional, noting that it extended "an umbrella of protection for preferred private businesses while blocking others from competing, even if they satisfy all other regulatory requirements." But similar laws remain on the books in most states today.

This constitutional dimension reveals one flaw in the federalism argument that states have advanced for expanding *Parker* immunity: states should not be free to adopt policies that fall below basic federal protections for individual rights, including the right to economic liberty. If, as the Supreme Court claims, "the preservation of the free market and of a system of free enterprise

without price fixing or cartels is essential to economic freedom," then there can be no justification for granting *Parker* immunity whenever the state takes merely procedural steps—as by a *pro forma* declaration authorizing private entities to illegalize competition. Instead, immunity should be granted only when the state's restriction on competition is substantively justified.

Several antitrust scholars have argued that courts should require such a substantive showing before extending *Parker* immunity. Edlin and Haw, for example, propose that a Rule of Reason should apply to state restrictions on competition. Others have recommended that the Court require evidence of some market failure that the restraint redresses before it allows that restraint to withstand an antitrust lawsuit. But given the way state-established cartels often violate constitutional rights, a test drawn from constitutional law would be most apt. State immunity should apply only when the restraint on trade that the state commands and actively supervises also substantially advances an important government interest.

A rational basis test would be excessively deferential and would enable states to grant immunity essentially whenever they choose, contrary to national policy. Instead, an intermediate form of means-ends scrutiny would accord states an appropriate degree of flexibility while preventing them from undermining federal law. That test would require a state to articulate an important goal to be accomplished by exempting private parties from federal antitrust laws and require that the exemption actually serve that end before waiving the applicability of federal antitrust law.

States would, no doubt, view such a test as unduly infringing on their autonomy. That concern seems weak in light of the fact that federal antitrust law has already deeply enmeshed the courts in national economic policy. Major elements of antitrust law are the products of court rulings, not legislative or even administrative decisionmaking. A realistic limit on the availability of antitrust immunity does not unjustly interfere with democratic decisionmaking at the state level because antitrust laws already proclaim national economic policy—one that proscribes cartel behavior by private parties trying to exclude their rivals from the marketplace. The Supreme Court has claimed that antitrust law focuses on "the result[s]" of anticompetitive conduct, not "the form of the combination or the particular means used." Refusing to immunize anticompetitive conduct on the basis of a state's mere say-so is entirely consistent with a healthy federalism.

Moreover, judicial deference is usually applied only where the democratic process is sufficient to prevent abuses. But that process is certainly not enough to block private parties from abusing their antitrust immunity. Voters are usually unaware of a state's anticompetitive laws, especially where they are couched in the vague terms of a "permissive policy." As Edlin and Haw observe, consumers genuinely suffer from state restrictions on competition, but they "lack the incentive to participate in the process of licensing regulation; rarely would it be rational for a consumer to take the time and effort to try to change a licensing rule in the hopes of getting a cheaper haircut." This concern is only heightened when, as in the North Carolina case, neither the legislature nor voters have any direct control over those engaged in the anticompetitive conduct in the first place.

If federal law is to prohibit restraints on competition and conspiracies against trade, those prohibitions should presumptively apply to everyone equally, and particularly in cases in which state laws are used to block competition. As James Madison observed in *The Federalist*, a legal system that exempts the government from rules that apply to ordinary citizens undermines "the communion of interests and sympathy of sentiments ... without which every government degenerates into tyranny." If Americans ever became so "debased" as to "tolerate a law not obligatory on the legislature, as well as on the people," he warned, "the people will be prepared to tolerate any thing but liberty." This is not a merely rhetorical concern; state-established cartels tend to reward privileged insiders against entrepreneurs who lack political influence and thus to perpetuate a class system that blocks the route to economic independence for those who need it most.

Parker immunity should thus be limited not only to cases in which state officials carefully oversee the regulations at issue, and—contrary to *Southern Motor Carriers*—in which states actually require anticompetitive behavior, but also where the restriction on competition passes a meaningful constitutional test. Although the North Carolina case involves antitrust statutes instead of constitutional claims, the issues are identical: where established firms wield government power, they have a strong incentive to do so in ways that restrict competition, harm consumers, and block entrepreneurs from exercising their right to earn a living.

Courts must shed their infatuation with federalism in the realm of antitrust immunity and adopt a strict rule limiting such immunity to cases where states explicitly choose to restrict competition, carefully supervise those who do so, and do so for legitimate reasons. Today's more permissive rules allow states far too much discretion to establish cartels and block entrepreneurs—who have no realistic political protection against vested interests that exploit *Parker* immunity—from their constitutional right to earn a living. The substantial advancement test already used in several areas of constitutional law would give states enough flexibility to restrain trade where doing so is legitimate, while ensuring that entrepreneurs are not left at the mercy of the very firms that have the strongest interest in barring them from competition. *R*

READINGS

- "Antitrust Regulation of Land Use: Federalism's Triumph over Competition, the Last Fifty Years," by E. Thomas Sullivan. *Washington University Journal of Law and Policy,* Vol. 3 (2000).
- "Cartels by Another Name: Should Licensed Occupations Face Antitrust Scrutiny?" by Aaron Edlin and Rebecca Haw. *University of Pennsylvania Law Review*, Vol. 162 (2014).
- "Mere Refinement of the State Action Doctrine Will Not Work," by Peter Hettich. *DePaul Business and Commercial Law Journal*, Vol. 5 (2006).
- "White Out: How Dental Industry Insiders Thwart Competition from Teeth-Whitening Entrepreneurs," by Angela C. Erickson. Institute for Justice, April 2013.