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Expert Analysis

Supreme Court Takes Case to Clarify State Action Immunity Doctrine

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On March 3, 2014, the Supreme Court granted certiorari in *North Carolina State Board of Dental Examiners v. FTC*, a U.S. Court of Appeals for the Fourth Circuit decision upholding a Federal Trade Commission (FTC) finding that the North Carolina State Board of Dental Examiners did not qualify for antitrust immunity after excluding non-dentists from providing teeth-whitening services. The Supreme Court will determine whether the board is a "private" actor for purposes of the state action doctrine, a designation that heightens the requirements for receiving antitrust immunity. This will mark the second time in two years that the Supreme Court has considered the parameters of the state action doctrine, following nearly two decades of silence on the subject.

If the Supreme Court elects to impose "active supervision" on private regulatory bodies, the decision could have broad implications on the structure and authority of state professional review boards, placing increased costs on states and reducing the incentive of professionals to participate on these boards. At the same time, however, these concerns must be weighed against the risk of allowing established market participants to use state action immunity to harm competition or prevent new competitors from entering the market.

State Action Doctrine

The Supreme Court first established state action immunity in the 1943 decision *Parker v. Brown*, where the State of California was charged with violating the Sherman Act by enacting legislation that permitted raisin growers to fix prices.[1] The court held there was no Sherman Act violation as the antitrust laws were not intended to restrict the sovereign capacity of states to regulate their economies, especially in circumstances where the state itself takes direct action.[2] Decisions following *Parker* extended this immunity to political subdivisions of the state, such as municipalities, when their actions were taken pursuant to a "clearly articulated and affirmatively expressed" state policy.

In 1980, the Supreme Court further clarified that state-authorized private action may also be shielded from the antitrust laws under the state action doctrine. In *California Retail Liquor Dealers v. Midcal Aluminum,* the Supreme Court set forth a two-prong test (Midcal) for determining whether private action warranted antitrust immunity.[3] First, "the challenged restraint must be one clearly articulated and affirmatively expressed as state policy; second, the policy must be actively supervised by the State itself."[4]

Lower courts grappled to apply this test to different pseudo-state actors in varying circumstances, which resulted in a lack of consistent decisions. In fact, the FTC released a report in 2003 detailing the conflicting interpretations of the state action doctrine and offered several recommendations for strengthening and clarifying both prongs of the test.[5] The Supreme Court, however, declined to weigh in on the doctrine until last year in *FTC v. Phoebe Putney Health System*, 133 S.Ct. 1003 (2013).

'Phoebe Putney'

In *Phoebe Putney*, the Supreme Court determined that a hospital merger approved by a Georgia county hospital authority violated antitrust laws and was not subject to state action immunity because the law failed the first prong of *Midcal* requiring a clearly articulated state policy. The justices voted unanimously to narrow the state immunity doctrine, holding "clear articulation" requires that a state not only permit the conduct at issue, but also affirmatively contemplate displacing competition in

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order for the challenged anticompetitive effects to be attributed to the state.

The court found that while the Georgia law at issue granted the hospital authority general corporate powers, including the power to actually acquire hospitals, the law did not "clearly articulate and affirmatively express a state policy empowering the Authority to make acquisitions of existing hospitals that will substantially lessen competition."[6] The court concluded by reaffirming the principle "that state action immunity is disfavored."[7] Although the Supreme Court also granted certiorari on the second prong of *Midcal*, the court ultimately declined to address the "active supervision" requirement, given the law failed on the first prong.

'North Carolina State Board'

The Supreme Court apparently realized it needed to clarify the second prong of the state action doctrine by granting certiorari to *North Carolina State Board of Dental Examiners v. FTC*. Although the Phoebe Putney decision did not examine "active supervision" under the state action doctrine, the court's review of *Dental Examiners* promises to provide guidance that lower courts, and antitrust agencies, certainly could use. The question presented to the court is whether regulatory bodies comprised of market participants are considered private actors, thus requiring active state supervision before receiving antitrust immunity.

The North Carolina State Board of Dental Examiners, designated a "state agency" by statute, is comprised of six licensed dentists, one licensed dental hygienist and one consumer member. The governor appoints the consumer member, while dentists elect the dental members and dental hygienists elect the hygienist member.[8] The board is tasked with enforcing North Carolina's Dental Practice Act, which governs the licensing of dentists and their professional conduct.

In 2003, growing demand for teeth-whitening services led non-dentist providers to enter the market for such services, often offering lower prices than practicing dentists.[9] The board received several complaints from licensed dentists, many of whom mentioned this price undercutting. As a result, the board sent cease and desist letters to the non-dentist providers of teeth-whitening services, causing some of these providers to leave the market.[10] The FTC filed an administrative complaint charging the board with violating Section 5 of the FTC Act. The board countered that as a state agency, it was immune from antitrust scrutiny.

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The FTC found that the board was a private party required to meet both prongs of *Midcal* and failed to prove adequate supervision by the state. The FTC prohibited the board from unilaterally sending cease and desist letters to teeth-whitening providers in North Carolina.[11] The board petitioned the Fourth Circuit for review.

On appeal, the Fourth Circuit affirmed the FTC's decision that the board must satisfy both prongs of *Midcal* because an "agency…operated by market participants who are elected by other market participants…is a 'private' actor."[12] To support this decision, the court highlighted the risk of the board engaging in anticompetitive activity under the guise of state action. It distinguished circumstances where a state agency may receive immunity without active supervision:

> When a state agency and its members have the attributes of a public body—such as a municipality—and are subject to public scrutiny such that there is little or no danger that [they are] involved in a private price-fixing arrangement, active supervision is not required. However, when a state agency appears to have the attributes of a private actor and is taking actions to benefit its own membership…both parts of *Midcal* must be satisfied. Requiring active supervision over such entities ensures the State has exercised sufficient independent judgment and control.[13]

As the board here was comprised of economic participants of the regulated market, the board was not entitled to immunity unless there was active supervision. The board could not satisfy this requirement, as the cease and desist letters were sent without state oversight or judicial authorization.[14] The court then concluded that the board had the ability to conspire under Section 1 of the Sherman Act and sending the cease and desist letters amounted to concerted action to close the market for teeth-whitening services.[15] The court affirmed the FTC's finding that this behavior amounted to an unreasonable restraint of trade.

Judge Barbara Milano Keenan wrote a separate concurrence, emphasizing the narrowness of the holding. She wrote that a state agency comprised (in whole or in part) of members participating in the market regulated by the state agency will not always be considered a private actor, but this decision turned on the fact that the members of the board were elected by other private participants in the market. "[I]f the Board members here had been appointed or elected by state government officials pursuant to state statute, a much stronger case would have existed to remove the Board from the reach of *Midcal's* active supervision prong."[16]

On Oct. 23, 2013, the board filed for Supreme Court review. In its petition, the board again argued that it is a state actor for purposes of state action immunity, referencing its governmental powers that private actors do not traditionally have, such as enacting rules governing dentistry (backed by criminal penalties), issuing

licenses and conducting investigations into any violations of its regulations.[17] For judicial support, the board cited two decisions from 1989 and 1998 in the U.S. Court of Appeals for the Ninth and Fifth Circuits, respectively, which provided that private regulatory bodies operated by market participants were immune from antitrust scrutiny.[18] Several state professional boards have filed briefs in support of the board.

Competing Considerations

In determining the scope of the supervision requirement, the Supreme Court will likely consider the policy implications referenced by the interested parties. One factor put forth by the board is the detrimental effect an active supervision requirement may have on board participation. Professionals may be reluctant to serve on a professional board for fear of being subject to individual liability. Even if members of the professional community still are willing to participate, the fear of liability could prevent agency members from vigorously enforcing some of the less popular regulations. This "chilling" effect could eventually result in added harm to consumers.

The board pointed out that requiring active supervision may also result in states entirely prohibiting market participants from being a part of the regulatory body, in order to minimize the risk of antitrust lawsuits. According to the board, this could leave the states to regulate "without their desired level of professional involvement," which diminishes the usefulness of the agencies.[19]

The court may also consider the burden on states to find the resources to supervise professional organizations. A bipartisan group of attorneys general—representing the states of Alabama, Colorado, Delaware, Florida, Kansas, Maryland, North Carolina, Ohio, South Carolina, and West Virginia—asked the court to review the Fourth Circuit's ruling and argued that requiring active supervision will create an uneven playing field by forcing states to create additional levels of bureaucracy, which adds costs and delays. Different states have varying capabilities to handle these extra burdens.

The Supreme Court will likely consider the effect on competition if, as described by the FTC, "active market participants who are economically affected by competitive threats from new entrants into the markets they serve" are allowed to enact and enforce trade regulations without state supervision.

The FTC countered these policy concerns by highlighting the risk of casting aside the unfettered forces of supply and demand to permit "economically self-interested private actors" to benefit at the public's cost.[20] The Supreme Court will likely consider the effect on competition if, as described by the FTC, "active market participants who are economically affected by competitive threats from new entrants into the markets they serve"[21] are allowed to enact and enforce trade regulations without state supervision. The risk that these market participants will use regulatory means to exclude new competitors could be a factor in the court's decision.

Conclusion

The Supreme Court's anticipated decision in *North Carolina State Board of Dental Examiners* will address an increasingly important issue in our ever changing economy, especially where new technologies or surges in demand draw entry into otherwise established product spaces. And, in this respect, the decision will provide an interesting window into whether the courts, in essence, are believers in markets free of "government" barriers—at least those controlled by private, market participants.

Thus, while the board in *Dental Examiners* has put forth several factors in support of state action immunity, these policy considerations are up against significant Supreme Court jurisprudence that weigh in favor of limiting state action immunity. The Phoebe Putney decision, which continued to narrow the doctrine, suggests the board may face heavy scrutiny before the current court in arguing in favor of antitrust immunity. It would not be surprising for the court to continue narrowing the doctrine and require some sort of state oversight when dealing with private regulatory bodies. It is important to note, however, that the Supreme Court granted certiorari despite the FTC prevailing at every lower court level, which may suggest that the court is concerned with some aspect of the FTC's reasoning. In any event, this is certainly a case to follow as it goes forward.

1. *Parker v. Brown*, 317 U.S. 341, 351 (1943) ("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…an unexpressed purpose to nullify a state's control over its officers and agents is not lightly to be attributed to Congress.").
2. Id.
3. *California Retail Liquor Dealers v. Midcal Aluminum*, 445 U.S. 97, 105 (1980).
4. Id. (internal quotations removed).
5. Office of Policy Planning, FTC, Report of the State Action Task Force, at 51-57 (2003), available at http://www.ftc.gov/os/2003/09/stateactionreport.pdf.
6. *FTC v. Phoebe Putney Health System*, 133 S.Ct. 1003, 1012 (2013).
7. Id. at 1016 (internal quotations omitted).
8. *North Carolina State Bd. of Dental Examiners v. FTC*, 717 F.3d 359, 364 (2013).
9. Id. at 365.
10. Id.
11. Id. at 366.
12. Id. at 370.
13. Id. at 369.
14. Id. at 370.
15. Id. at 373.
16. Id. at 376.
17. Brief for Petitioner at 3, *North Carolina State Board of Dental Examiners v. FTC*, 717 F.3d 359, 364 (2013) (No. 13-534).
18. Id. at 14-16 (discussing *Earles v. State Bd. of Certified Pub. Accountants of La.*, 139 F.3d 1033 (5th Cir. 1998) and *Hass v. Oregon State Bar,* 888 F.2d 1453 (9th Cir. 1989)).
19. Brief for Petitioner at 3.
20. Brief for Respondent, at 16, *North Carolina State Board of Dental Examiners v. FTC*, 717 F.3d 359, 364 (2013) (No. 13-534).
21. Id. at 14.

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