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Report from Washington

The Supreme Court Again Considers Scope of the State Action Exemption to Federal Antitrust Enforcement

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The Supreme Court heard oral arguments this week in *North Carolina Board of Dental Examiners v. Federal Trade Commission*, No. 13-534, a case in which the Court will determine whether a state regulatory board, composed primarily of private market participants who are elected to their positions by other market participants, is a private rather than state actor for purposes of the state action exemption to federal antitrust law.

The state action antitrust exemption, first recognized in *Parker v. Brown*, 317 U.S. 341 (1943), provides that federal antitrust laws "should not be read to bar States from imposing market restraints 'as an act of government.'" *FTC v. Phoebe Putney Health Sys., Inc.*, 133 S. Ct. 1003, 1010 (2013). Under the state action doctrine, state legislative actions may be exempt from the operation of federal antitrust laws. However, when the activity at issue is not directly that of the state, but is instead carried out by private parties pursuant to state authorization, a closer analysis is required. *See Hoover v. Ronwin*, 466 U.S. 558, 568 (1984). In *California Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc.*, the Supreme Court held that private parties may invoke the state action exemption only when their conduct is (1) authorized by a "clearly articulated . . . state policy" to displace competition, and (2) "actively supervised" by state officials. 445 U.S. 97, 105 (1980). By contrast, municipalities may invoke the state action exemption simply by satisfying the first prong of the *Midcal* two-part test. *Town of Hallie v. City of Eau Claire*, 471 U.S. 34, 46-47 (1985). In *Hallie*, the Court suggested that similar to municipalities, "in cases in which the actor is a state agency, it is likely that active state supervision would also not be required." *Id.*

It remains uncertain whether a state regulatory board is a "private actor" subject to the active supervision requirement, particularly when a majority of the board's members are also market participants who are elected to their positions by other market participants. The Fifth and Ninth Circuits have thus far declined to apply the active supervision requirement to state agencies operating pursuant to state law, even when the agencies' officials were private

market participants. *See Earles v. State Bd. of Certified Pub. Accountants of La.*, 139 F.3d 1033, 1041 (5th Cir. 1998); *Hass v. Oregon State Bar*, 883 F.2d 1453, 1461 (9th Cir. 1989). But in *North Carolina Board of Dental Examiners v. Federal Trade Commission*, the Fourth Circuit held that an official state regulatory board made up of market participants is a "private actor" and thus must satisfy *Midcal*'s two-part test, by demonstrating both a "clearly articulated . . . state policy" and "active supervision" by the state, to be exempt from federal antitrust law. 717 F.3d 359, 370 (4th Cir. 2013). The Court's decision this term in *North Carolina Board of Dental Examiners* should resolve this split and offer guidance as to whether professionally appointed bodies are state or private actors.

Background

In *Parker*, the Supreme Court established that federal antitrust law does not "restrain a state or its officers or agents from activities directed by its legislature." 317 U.S. at 350-51. The Court in *Parker* embraced conflicting goals of ensuring that states as sovereigns could exercise control over their officers and agents, while also not going so far as to provide immunity to private individuals who are in violation of federal antitrust law. *Id.* at 351. The exemption from antitrust enforcement extends to private parties when two requirements are met. First, their conduct must be authorized by a "clearly articulated . . . state policy" to displace competition. *Midcal*, 445 U.S. at 105. Second, their conduct must be "actively supervised" by state officials. *Id.* The test is even easier to satisfy for municipalities, which are granted immunity under the state action doctrine so long as the first requirement, a clearly articulated state policy, is met. *Hallie*, 471 U.S. at 46-47. The Court in *Hallie* suggested that similar to municipalities, state agencies may not be required to meet the active supervision prong of the *Midcal* test. *Id.* But, another Supreme Court case, *Goldfarb v. Virginia State Bar*, suggests that when a state agency has the attributes of a private actor and takes actions to benefit its own membership, both prongs of the *Midcal* test must be satisfied. *See* 421 U.S. 773 (1975).

North Carolina Board of Dental Examiners involves the application of the state action exemption to a state board composed of private market participants who are elected to their positions by other private market participants. Petitioner, the North Carolina Board of Dental Examiners, is a state agency created to regulate the practice of dentistry. The board is largely composed of licensed dentists who are elected directly by other licensed dentists in North Carolina. Under North Carolina law, it is illegal to practice dentistry, including removing stains from human teeth, without a license from the board. In 2006, the board enforced a ban on unlicensed stain removal by sending cease-and-desist letters on its official letterhead to non-dentist teeth whitening providers. In addition, the board asked shopping

mall operators to cease leasing kiosks to non-dentist teeth whitening providers, and persuaded the North Carolina Board of Cosmetic Art Examiners to notify its licensed salons and spas that teeth whitening requires a state dental license. These enforcement efforts successfully caused non-dentist providers in North Carolina to stop providing teeth whitening services.

In 2010, the FTC issued an administrative complaint against the board, alleging it had violated Section 5 of the FTC Act, 15 U.S.C. § 45(a)(1) by anti-competitively excluding non-dentists from the market for teeth whitening services in North Carolina. In particular, the FTC's complaint alleged that through cease–and-desist letters and other related conduct, the board had engaged in concerted action with the intent and effect of excluding competition. The board moved to dismiss the complaint, claiming immunity based on the state action exemption. An Administrative Law Judge (ALJ) denied the board's motion, and the FTC affirmed. The board then filed a federal declaratory action requesting that a federal court stop the administrative proceeding, which was dismissed as an improper attempt to enjoin an ongoing administrative proceeding.

At a hearing on the merits, the ALJ issued an opinion finding that the board violated the FTC Act. On appeal, the FTC affirmed the ALJ's decision, and entered a final order against the board that included a cease-and-desist order enjoining the board from continuing to unilaterally issue extra-judicial orders to non-dentist teeth whitening providers in North Carolina. The FTC assumed that the board's conduct met the "clearly articulated" prong of the *Midcal* test. However, the Commission found that the board also had to demonstrate that its conduct was "actively supervised by the state itself." *North Carolina Board of Dental Examiners*, 151 F.T.C. 607, 607. The FTC reasoned that a state regulatory body that is controlled by participants in the very industry it purports to regulate must be actively supervised by a component of the State that is not. The FTC stated that the operative factor in determining whether active supervision of the state is required is a "tribunal's degree of confidence that the entity's decision-making process is sufficiently independent from the interests of those being regulated." *Id.* at 619. The board then petitioned the Fourth Circuit for review of the FTC's final order.

The Fourth Circuit denied the board's petition for review under the FTC Act. In so doing, the Fourth Circuit agreed with the FTC that when market participants who are elected by fellow market participants operate a state agency, this constitutes "private action" for purposes of the state action exemption. Therefore, "state agencies in which a decisive coalition . . . is made up of participants in the regulated market, who are chosen by and are accountable to their fellow market participants," must satisfy the *Midcal* test, including the active

supervision requirement, to claim antitrust immunity under the state action exemption. *North Carolina State Board of Dental Examiners v. Federal Trade Commission*, 717 F.3d 359, 368 (4th Cir. 2013). The Fourth Circuit distinguished *Parker*, holding that the actions of the board were not really state government actions because North Carolina neither actively supervised the board, nor directed it to pursue any particular policy. *Id.* at 375. Similar to the FTC, the Fourth Circuit reasoned that it is necessary to ensure that "the State has exercised sufficient independent judgment and control" over state agencies, even when their conduct is authorized by a clearly articulated anticompetitive state policy. *Id.* at 369. The circuit court cautioned, "[W]e recognize state action immunity only when it is clear that the challenged anticompetitive conduct is undertaken pursuant to a regulatory scheme that 'is the State's own.'" *Id.* at 368 (quoting *FTC v. Ticor Title Ins. Co.*, 504 U.S. 621, 636 (1992)). Judge Keenan concurred, emphasizing the narrow scope of the court's holding, and discussing that the fact that the board was comprised of private dentists, along with North Carolina's lack of active supervision of board activities, left the court with "little confidence that the state itself, rather than a private consortium of dentists, chose to regulate dental health in this manner at the expense of robust competition for teeth whitening services." *Id.* at 377.

On March 3, 2014, the Court granted the board's petition for writ of certiorari. The board's petition argued that the Fourth Circuit's decision contradicts past precedent and other circuit court decisions, which have only required state agencies to meet the "clearly articulated state policy" requirement.

Summary of the Argument

At oral argument, counsel for the North Carolina Board of Dental Examiners opened the argument by asserting that "a State regulatory agency does not lose its state action antitrust immunity simply because the agency is run by part-time public officials who are also market participants in their personal capacities." The board's counsel argued that: (1) respect for federalism requires deference to a state's sovereign choices concerning how to structure its regulatory agencies; (2) the regulatory conduct of public officials who are market participants cannot be equated with the conduct of private businesspeople; and (3) the FTC's position to the contrary would be "massively and needlessly disrupt[ive]."

Justice Alito asked how one would determine if a state decision-making body is "public" or "private" for purposes of the state action exemption. The board's counsel responded that the "fundamental key is that it's not just they're designated as State officials but they are charged with a State law duty to enforce State law. They are not acting pursuant to their unfettered private discretion to choose whatever . . . choices maximize their personal profit."

Justices Breyer, Ginsburg, and Kagan indicated that private actors may require state supervision to ensure that they are not elevating their self-interests above articulated state policy. Justice Ginsburg questioned, if the board is both state and private, and given the risk of self-interested behavior, why shouldn't there be "a check of the kind that *Midcal*" imposed on private actors? The board's counsel responded that "fundamentally, it is a question for the State to determine whether it wants to bear that risk. These are the State's officials and the State has made a different choice. The State has decided that the benefits of having market participants make decisions and not having their every decision actively second-guessed by higher level of bureaucracy is worth it." The board's counsel also emphasized that in *Hallie*, which exempted municipalities from the second prong of *Midcal* review, the Court's greatest concern was that states would authorize private actors to violate state law, not that state boards acting pursuant to state policies would act in their own self-interest. The board's counsel argued that the danger of private actors circumventing federal antitrust laws was not present in this case because the board members were acting pursuant to a clearly articulated state policy. But Justice Kagan disagreed. She noted that both of the *Midcal* prongs play an important role, and "to strip the second half of the test off is to leave the first half of the test essentially . . . unprotected. There's no way to make sure that the people are acting in accord with State policy rather than to serve their own interests." The board's counsel responded that the adequate supervision problem was one to be solved by state administrative review, and that "Federal antitrust law was never intended to second guess that question."

"So to strip the second half of the test off is to leave the first half of the test essentially . . . unprotected. There's no way to make sure that people are acting in accord with State policy rather than to serve their own interests."

— Justice Kagan

The FTC's counsel began by stating that the board's members here have "an evident self-interest" in how the dental profession is regulated. The FTC's counsel argued "that natural self-interest is reinforced by the method of selection." When questioned by Justice Kagan on whether the dental board's election by other market participants was critical to the FTC's case, the FTC's counsel responded that it was not. However, the FTC's counsel did signal that it was important to the FTC's case that North Carolina specifically required its board members to be dentists. Nevertheless, the FTC's counsel went on to say that "there's no problem with . . . boards being staffed by active practitioners so long as they are adequately supervised."

"I don't want to suddenly destroy the temptation of medical boards throughout the country to decide everything in favor of letting in the unqualified person, lest he sue them under antitrust law. . ."

— Justice Breyer

Justice Breyer, like several of the other Justices, appeared conflicted. On the one hand, Justice Breyer opined that granting immunity from federal antitrust law to a state dental board of private actors is akin to allowing wine merchants to set their own prices. On the other hand, Justice Breyer noted that there would be a problem if neurologists were unable to use their knowledge as specialists to weigh in on the qualifications of someone applying to work in that field. Justice Breyer argued, "I don't want to suddenly destroy all the temptation of medical boards throughout the country to decide everything in favor of letting in the

unqualified person, lest he sue them under the antitrust law . . . .” The FTC’s counsel maintained that a board made up of private actors should be supervised by the state, although did not provide a clear response to questioning about the appropriate level of supervision.

“I think that’s what troubles me about your position because it seems to lead to a case, State by State, board by board, inquiry by the Federal courts as to whether the members of a regulatory body are really serving the public interest or whether they have been captured by some special interest.”

— Justice Alito

Another important concern expressed by the Justices during the FTC’s argument was whether a decision to subject state boards comprised of private actors to state supervision would deter anyone with expertise from serving on state medical and dental boards. Justice Alito asked if the FTC’s argument would lead to a “State by State, board by board, inquiry by the Federal courts as to whether the members of a regulatory body are really serving the public interest or whether they have been captured by some special interest?” Justice Sotomayor encouraged the FTC’s counsel to articulate a rule about which state entities should be considered private. The FTC’s counsel answered, “if the Court wanted to say, as part of its opinion, as long as they are actually required by law to be practicing dentists, there’s no State action immunity . . . we would prefer that to a decision that says we’re going to give these boards a blanket pass because we can foresee some hard questions at the end of the day.” In closing the FTC’s counsel argued, “This case is about dentists regulating non-dentists and, in particular, dentists telling . . . non-dentists in what endeavors can you legally compete with dentists. And so the concerns that underlie the Sherman Act with unfair restrictions on competition are at their zenith in a case like this one.”

Implications

In deciding this case, the Court is expected to clarify which characteristics of state agencies eliminate the possibility of self-interested behavior such that they are considered to be public actors and thereby entitled to federal antitrust immunity under the state action doctrine. Affirmance of the Fourth Circuit’s ruling could have a substantial impact on state medical and dental professional boards composed of private practitioners, by eliminating their federal antitrust immunity unless they are subject to close state supervision. However, a ruling in favor of the board could leave private actors in public roles free to regulate in their own self-interests without state supervision or antitrust liability. Several Justices raised concerns about the drawbacks of ruling in favor of the FTC, such as deterring experienced professionals from serving on similar state boards. At the same time, other Justices noted all that would be required to circumvent this issue would be closer state supervision of these professionals to ensure the state’s—and not the private members’— interests are advanced. The Court’s decision will therefore have a significant impact on similar hybrid regulatory agencies across the nation and the scope of the state action doctrine.

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