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Antitrust Enforcement in the US and the EU

A Comparison of the Two Federal Systems

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18.1 INTRODUCTION

This chapter offers commentary on a normative question: to what extent should antitrust enforcement (and regulatory authority more generally) be centralized and to what extent should the authority be delegated to lower levels of government? While this question has implications worldwide, I will use the European Union and the US as the focal point of my analysis. The underpinnings of the antitrust enforcement structure are different in the two federal systems. In the US, the driving force is the state action exemption doctrine, based on the common law, which spells out instances in which the center can enforce its federal antitrust statutes against anticompetitive state and local regulation. In the EU, however, the driving force is the principle of subsidiarity, which delegates powers to Member States unless a strong case can be made that the externalities are so substantial as to require actions from the center.

Fortunately, the normative question at issue here has been analyzed previously by a number of authors, the primary of whom is my colleague Eleanor Fox. No one is better situated to analyze this issue than Professor Fox, since she has devoted a substantial part of her academic career to the study of comparative antitrust analysis. While seeing pros and cons, Eleanor claims that the EU has it (more or less) right. In the EU, federalism trumps the Member States – Member State authorities have a duty to take on Member State laws that run counter to the interests of the Union.[1] Whereas, in the US, we must rely on a less than clear set of guidelines that flow from state action case law and the dormant commerce clause of the US Constitution. Moreover, as Professor Fox has pointed out, the US gives too much weight to state sovereignty (for example, the Eleventh Amendment prohibits

[1] See Eleanor M. Fox, 'State Action in Comparative Context: What if *Parker v. Brown* were Italian', in *International Antitrust Law and Policy: Fordham Corporate Law* (Juris, 2003), ch. 19; Eleanor M. Fox and Deborah Healey, 'When the State Harms Competition – The Role for Competition Law' (2014) 79 *Antitrust Law Journal*, 769.

suits in federal courts by citizens against states). In her view, the federal government should have greater authority to intercede when state actions affect national interests.

I offer a somewhat different perspective. While it may require a further statutory intervention, the US, as a fully formed political and economic system, has the ability to improve its federalism antitrust oversight. The same cannot be said of the EU, which is neither fully formed politically (witness the problems of Greece and Italy, Brexit, and a failure to deal coherently with the immigration problem) nor economically (witness the inability of the EMU to deal with the downturn of the European economy and a series of significant economic shocks). It has, however, had a relatively integrated/federal EU antitrust policy for decades and antitrust enforcement has one through various reforms, chiefly with decentralization and the adoption of Regulation 1/2003.

In the section that immediately follows, I briefly review the principle of subsidiarity and the state action exemption doctrine. Following that, I describe several of the important differences between the US and the EU; I explain why ~~it is likely that~~ the two enforcement systems are unlikely to achieve convergence with respect to the antitrust enforcement of regulatory activities; I conclude with several suggestions for possible reform.

18.2 THE US REGULATORY FEDERALISM: THE STATE ACTION EXEMPTION DOCTRINE

Over the past several decades the US Supreme Court has offered a process-oriented test that balances to a reasonable degree the norms of economic efficiency and political participation. In essence, the validity of a particular state regulation now depends heavily on whether that regulation has been clearly authorized by the state legislature and, if so, whether that legislature actively supervises the regulatory activity. This section offers a brief overview of the development of the "state action doctrine."

The US courts have faced issues of regulatory federalism in their efforts to resolve the inevitable tension between federal antitrust law and state business regulation through an evolving doctrine.[2] The conflict between state and federal interests has been longstanding in US constitutional history. This conflict has typically been resolved by a constitutional interpretation in which federal laws trump their state counterparts – witness the Supremacy Clause of the US Constitution, which resolves conflicts in favor of federal law. In contrast, however, the "state action doctrine" has typically resolved the tension between federal antitrust regulations

[2] This section builds on Robert P. Inman and Daniel L. Rubinfeld (with Robert Inman), 'Making Sense of the Antitrust State Action Doctrine: Balancing Political Participation and Economics Efficiency in Regulatory Federalism' (1997) 75, May *Texas Law Review* 1203.

and the states' sometimes anticompetitive regulation of business activities in favor of the states.

As spelled out by the Supreme Court's opinion in *Parker* v. *Brown*, the doctrine largely exempts the actions of states (and to a lesser extent localities) from the federal antitrust laws. The relevant doctrine is a two-pronged test requiring state regulations to be "clearly articulated" and "actively supervised." Moreover, my federalism co-author Robert Inman and I see the current doctrine as providing institutional protection for the goal of political participation, a goal this is arguably consistent with the objectives of the Sherman Act, especially as espoused during the populist era. Unfortunately, the ideals of a federal system (as Professor Fox and I are likely to agree) are not currently well protected by the current Supreme Court's view of the state action doctrine. The current US doctrine allows many state regulations which adversely affect the economic well-being of non-residents to stand, at a cost in potentially significant lost economic welfare. Indeed, *Parker* v. *Brown*, the cornerstone of the current state action doctrine, is just such a case.

In *Parker* v. *Brown*, the Court was asked whether California's Agricultural Prorate Act violated the Sherman Act.[3] California had established such a program in order to maintain the prices of and competition for a number of agricultural products. Under the program, ten producers of any crop within a production zone could petition the Prorate Advisory Commission to implement a restrictive marketing program. If the Commission agreed, a proposed program would then be drawn up and submitted for ratification by at least 65 percent of the growers. The Agricultural Prorate Act was challenged by a producer of raisins on the grounds that the Act violated the Sherman Act and the negative Commerce Clause.[4]

The Court noted that the marketing program would violate the Sherman Act if it had been devised solely upon the initiative of the producers. However, the Court further asserted that while Congress had the power (under the Commerce Clause) to prohibit anti-competitive state programs, Congress did not intend to prohibit states from undertaking regulatory activities approved and directed by state legislatures.[5] Underlying the Court's decision in *Parker* was its primary concern to protect state legislative sovereignty in a federalist system; the Court was not unusually troubled by the fact that the Prorate Act was clearly "anti-competitive,"

[3] *Parker* v. *Brown*, 317 US 341 (1943). Without the Parker holding, the Supremacy Clause of the US Constitution would invalidate all regulations that violated federal antitrust laws.

[4] The negative Commerce Clause is largely a court-developed doctrine that restricts states from discriminating against out-of-state residents. As such it stands as a possible constraint on the ability of states to approve regulations which generate out-of-state spillovers. Because of its narrow focus on discrimination toward out-of-state residents, however, the negative Commerce Clause does not act to limit regulations affecting only within state residents. Where the negative Commerce Clause does have a potential role to play is when a state business regulation creates significant interstate monopoly spillovers.

[5] *Parker*, 317 US at 341, 350–1 (1943).

cartelizing California's raisin producers by restricting output and raising the price of raisins.

In its dormant Commerce Clause analysis, the *Parker* court did concern itself with the substantive economic facts of the California regulation on residents within and outside the state, but importantly, it chose to evaluate those facts in political, rather than economic, terms. The court seemed persuaded by the fact that the raisin production was confined largely to California. However, the fact that 95 percent of raisins consumed in the US were grown in California was interpreted by the court not as a source of potential monopoly powers capable of causing harmful economic spillovers, but rather as a fortunate configuration of interests for ensuring maximum political participation by all interested raisin producers. In the opinion, the court rested its judicial restraint on a view of federalism emphasizing state legislative sovereignty: "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 over its officers and agents is not lightly to be attributed to Congress."[6] To the court, only the legislature of the state of California, and no other governmental unit, had the proper incentive to worry about the plight of the raisin growers of California.[7]

It seems clear that the *Parker* court understood there were economic consequences outside of California, but that absent any explicit action by Congress to remedy such consequences, the court believed that the action by the state legislature was sufficient to warrant the state action exemption. Looking favorably upon decentralized political decision-making, the court set the path along which all subsequent state action doctrine would evolve: the economic consequences of state regulations would be largely ignored, provided those regulations were decided by an open, participatory political process, as evidenced by state legislative involvement.

The court's decision in *California Retail Liquor Dealers Association* v. *Midcal Aluminum, Inc.*[8] was the defining step in the development of the court's current political participation test for state action immunity. The court faced the question of whether the involvement of a state agency in a per se violation of the antitrust laws – supporting a resale price maintenance scheme for wine distributors – would render the scheme immune from the federal antitrust laws. The state legislature had clearly authorized price setting and provided an enforcement mechanism, but the state did

[6] 317 US at 351. But the *Parker* court was clear that this protection would not extend so readily to municipalities. Because municipalities are not sovereign entities, the immunity granted by the court to the acts of states would only translate to the acts of a municipality if the municipality were acting under the explicit authority of the state; *Parker*, at 350–1.

[7] Interestingly, the Supreme Court's interest in the California raisin business has been reinvigorated in this most recent session. In *Horne et al.* v. *Department of Agriculture* (October term, 2014), the court reviewed an arrangement in which a portion of the net proceeds of the sale of raisins went into a reserve that was given to the Department of Agriculture free of charge. The court held that compensation for a taking was required in this case, even though the transfer involved personal rather than real property.

[8] 445 US 97 (1980).

not establish prices, review the reasonableness of price schedules, regulate the terms of fair trade contracts, monitor market conditions, or engage in any "pointed reexamination" of the program.[9]

After reviewing the facts, the court put forth a two-part participation test to determine whether a state regulatory system should be immune from antitrust liability: (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." The state interests identified by the state court were "to promote temperance" and to "[p]rotect small licensees from predatory market pricing policies of larger retailers." Although there was a clearly articulated state resale price maintenance policy approved by the state legislature, the liquor pricing program was deemed to violate the second prong of the court's proposed test. The court found there was no indication that the program was actively supervised, since there was no supervision or review of the prices set by the producers and wholesalers.

As an approach for protecting political participation of the citizens of the state in regulatory policymaking, *Midcal*'s two-part test has proven to be an important step forward. Requiring the clear articulation of the regulatory policy by the state legislature, the first prong helps to ensure that all interested parties know of and have the opportunity to be involved in the original political agreement. Demanding that the legislature actively supervise the approved regulation, the second prong assures the original participants that their initial bargain will be enforced. The second prong gives meaning to the first, for without supervision, interested individuals cannot be assured that their initial participation in the political process will be meaningful. Subsequent cases have reinforced the importance, and clarified the reach, of each part of *Midcal*'s two-part participation test.

Of particular interest to the antitrust community, it is notable that over time the court has tightened the constraint for regulations set by private parties. To illustrate, in *Ticor Title*[10] the Federal Trade Commission (FTC) sued six title insurance companies for unfair competition, alleging that they had fixed prices for title searches and examinations. The insurance companies belonged to rating bureaus which were licensed – but *not* appointed – by the state legislature, and which submitted rates to the state that went into effect if the state did not act within thirty days. Despite the fact that the insurers had participated in the rate-making process, the court denied state action immunity, holding that the state had not actively supervised the rate-making process. A rate-making policy that had been generated by the political process, absent active supervision by the state, may have been "captured" by the industry being regulated, a result contrary to the original regulatory goals.

[9] Ibid., at 105–6.
[10] *FTC* v. *Ticor Title Ins. Co.*, 504 US 621, 625 (1992).

More recently, in *North Carolina Dental* the Supreme Court supported a lower court's opinion that a state dental board's restriction on the provision of teeth-whitening services violated the Sherman Act because it was not adequately supervised by an independent state authority.[11] Licensing boards present a thorny problem because they have characteristics of both public and private entities. On the one hand, states authorize them to regulate certain aspects of their respective professions. On the other hand, they are typically composed of market participants, thus raising the specter of regulatory capture. In *North Carolina Dental*, seven of the eight members of the board were market participants who had been elected by their peers. The dispute sprang from the growing provision of teeth-whitening services, which the state's Dental Practice Act defines as a dental service, by non-dentists. In response to complaints by dentists, the board opened an investigation and ultimately issued cease-and-desist letters that succeeded in pushing non-dentist practitioners out of the market. In 2011, the FTC had ruled that the board's conduct was anticompetitive and the board appealed to the Fourth Circuit in part on the ground that as a formal state agency it is not subject to the active supervision test. The court disagreed, holding that the board is essentially a private actor since it is operated by market participants and its members are elected by market participants.[12] The Supreme Court's affirmation was on a 6:3 vote.

As in its specification of its clear articulation test, the court has defined the domain of the active supervision requirement with the goal of maximizing political participation clearly in mind. Local political participation is encouraged, as local residents are allowed to set local regulations subject to the limits of the enabling state statutes and to see those regulations enforced as they wish. Together the current state action doctrine's two-pronged *clear articulation* and *active supervision* test provides important safeguards for the goal of political participation. The most participatory of all political bodies – state and local government legislatures – are assigned a central responsibility for the design and enforcement of business regulations. Only when those branches of government have been pushed aside or ignored does federal government supervision through federal antitrust law come to bear. By showing a clear, but moderated deference to state and local legislatures – arguably the branches of government "closest to the people" – the Court significantly advances the goal of political participation in regulatory policymaking. It is in this sense that

[11] N.C. *State Board of Dental Examiners v. FTC*, 135 S. Ct. ___, 2015 WL 773331 (Feb. 25, 2015).

[12] A number of circuits have taken a different approach. In *Earles* v. *State Bd. of Certified Pub. Accountants*, the court ruled that a licensing board consisting entirely of market participants was exempt from the active supervision test because it is "functionally similar to a municipality" and "the public nature of the Board's actions means that there is little danger of a cozy arrangement to restrict competition" (139 F.3d 1033, 1041 (5th Cir., 1998)). In *Hass* v. *Oregon State Bar*, the court applied a more nuanced analysis and exempted the Board of Governors of the state bar from the active supervision test after considering a number of factors that appeared to restrain the board's ability to pursue private interests, including: three of the board's fifteen members were non-lawyers; the records and accounts of the bar were open to public inspection; the members of the board were subject to a code of ethics applicable to all public officials (883 F.2d 1453, 1460 (9th Cir., 989)).

the US federal system of antitrust enforcement may have some advantage over the European system – a system that has some rigidity and substantial political uncertainty.

As currently constituted, however, the US system fails miserably with respect to the treatment of externalities. While the current state action doctrine offers citizens a clear political voice in determining regulatory policies *within* their state, the present doctrine offers no such protection for regulatory policies decided in neighboring states. Such protections are neither needed nor desired when state policies have no cross-border economic effects. But when one state's economic regulations create significant interjurisdictional economic spillovers, then affected residents in neighboring states may be harmed. More about this central, crucial issue momentarily.

18.3 EU ANTITRUST FEDERALISM: THE PRINCIPLE OF SUBSIDIARITY

In the context of the EU, subsidiarity is a principle of governance designed to give meaning to the divisions of responsibility between the center and the Member States. The principle seeks to allocate responsibilities for policy formation to the lowest level of government at which the objectives of that policy can be successfully achieved. Inman and I have explained that this principle is consistent with and supportive of a system of decentralized federalism.[13] In the context of the European Union, decentralized federalism would combine the Tiebout model of competitive Member State governments with Ronald Coase's model of efficient bargaining. The assignment of governmental functions in this world allocates all policy responsibilities, at least initially, to the Member States. Member states then have the option of jointly allocating some of their responsibilities to the center. Deciding what those centrally allocated policies should be, belongs (in principle) to the European Parliament and the Council of Ministers.

The success of a system of decentralized federalism that is consistent with the principle of subsidiarity is open to debate. As witnessed by recent events, there is a limit to the ability of Member States to protect individual rights to personal freedom, political rights, and property rights. A strong center is required to ensure the right of individual's to move freely and to support the rights of Member States to enforce policies that do not generate substantial externalities. From my perspective, the goal of a fully formed EU political entity should be modeled on a system of democratic federalism, one which builds on the advantages of a centralized EU "constitution" that protects rights and promotes political participation. However,

[13] Robert P. Inman and Daniel L. Rubinfeld, 'Subsidiarity and the European Union', in Peter Newman (ed.), *The New Palgrave Dictionary of Economics and Law* (Macmillan, 1998), 545; Robert P. Inman and Daniel L. Rubinfeld, 'Subsidiarity, Governance, and E.U. Economic Policy' (2002) 3(4) *CESifoForum* 3.

consistent with basic federalism principles, the assignment of governmental responsibilities should be made so that responsibilities are given to the governmental unit that can make the strongest contribution to ensuring personal, political, and economic liberties.

That is the theory; I now move on to consider how the two regimes have compared in practice.

18.4 A COMPARISON OF THE TWO REGIMES

On paper, application of the principle of subsidiarity to the allocation of responsibilities for the oversight of competition issues appears well suited to foster the principles underlying the ideals of a system of democratic federalism. Indeed, the application of the subsidiarity principle effectively codifies a reasonable and potentially efficient treatment of externalities. With respect to antitrust-related issues, there are a number of articles that provide a relatively rigid set of rules that define antitrust federalism. First, Articles 34 and 35 TFEU prohibit state measures that restrain imports or exports. This is strongly suggestive of a "no externality" rule.[14] Second, Article 4(3) TEU (ex Article 10 TEC) makes it clear that Member States "shall facilitate the achievement of the Union's tasks," and therefore do not undertake actions that would reduce the effectiveness of EU competition law.[15] Furthermore, there is no equivalent to the US's Eleventh Amendment which protects (under certain conditions) sovereign state entities from suit claiming certain violations of the federal antitrust laws.

Third, if there is conduct that is seen to violate Article 101 TFEU (restraints of trade), Member State competition authorities have a responsibility to "disapply" the national legislation and may impose penalties on conduct that was encouraged by the national legislation. Professor Fox provides a wonderful example that supports the clarity of EU law at least as seen in comparison to the US. In her 2003 "Italian paper," Fox takes a close looks at an important EU federalism case: *Italian Matches: Commission* v. *Italy*.[16] Italy had delegated the right to set tariffs to a competitor's association. The court concluded that the competitor's association had the ability to set minimum and maximum prices, and as such violated Article 101 TFEU. So, the

[14] As Fox, 'State Action', at 471 points out, "EC law has Articles 28 and 29 [now Articles 34 and 35 TFEU], which are stronger versions of the US Commerce Clause. While the US Constitution says merely that Congress can regulate commerce, and it impliedly prohibits state measures that constitute undue burdens on commerce (the dormant Commerce Clause), the EC Treaty states affirmatively that Member States may not impose 'quantitative restrictions' or 'measures having equivalent effect' on imports [Article 34 TFEU] or exports [Article 35 TFEU]."

[15] Note, in particular, the claim of Wainwright and Bouquet that Article 4(3) TEU (former Article 10 TEC) requires the EU "not to adopt or maintain in force any measure which could deprive [EC competition law] of its effectiveness" (Richard Wainwright and Andre Bouquet, 'State Intervention and Action in EC Competition Law' (2004) *Fordham Corp. L. Inst.* (B. Hawk ed.), 539, 540).

[16] (CNSD), Case 35-96, [1998], ECR I-3851.

US's *Parker* v. *Brown* decision, still relevant in US jurisprudence, would likely be overturned if subject to EU law.

Fox spells out a clear, articulate interpretation of the application of EU law to competition issues. Specifically, she comments that "[w]hen States violate EC law, injured private persons and the Member States' own antitrust authorities and courts may hold them to account. Indeed, Member State competition authorities may have a duty – among their many other tasks – to ferret out offending Member State law."[17] To further cement the point that the EU treats the externality question directly, Fox points out that "[t]he States cannot fulfill the task of harmonizing rights of state regulation with rights of free trade and competition as well as the center; too much deference to state sovereignty on this point and for this task will unacceptably undermine Community."[18]

For these and other reasons, as it currently stands the EU antitrust regime offers a clearer delineation of powers and functions than does the US system. Were the discussion to stop at this point, one would have to agree that with respect to antitrust federalism, the EU design trumps currently US law. But, to this outsider, the EU system is missing several elements that are not as easily remedied. First, there appears to be an incomplete accounting of the political economy of Member State regulatory politics – one that shows an appreciation of the benefits of local political participation – a reflection of the differing values of local cultures and local political and economic interests. Second, the EU relies heavily on a model of cooperative federalism – a model that is breaking down as Member State interests are beginning to trump federal interests – Brexit and Greece being two recent examples. Third, the agenda-setting powers of the Council of Ministers is limited and the politics of universalism (Member States acting in their self-interest rather than the federal interest) appears to characterize the behavior of the expanded European Parliament. A more ideal model – democratic (decentralized) federalism, which incorporates the principle of subsidiarity and a stronger system of EU governance, and which was largely the objective underpinning modernization and the adoption of Regulation 1/2003, seems less and less attainable.

Professor Fox's advocacy of the EU antitrust regime is compelling. Indeed, it is hard to disagree with her compelling argument that the European Union's law of state action is "significantly more competition-friendly than its counterpart in U.S. law."[19] But, as just described, its future is uncertain as the internal politics of the EU ebbs and flows. Furthermore, the structural design of the EU leaves the effectiveness of rights and activities relating to political participation uncertain. While preferences driven by local

[17] Fox, 'State Action', 473.

[18] For an updated perspective, see Fox and Healey, 'When the State Harms Competition', in which the authors point to areas in which nations' competition laws can usefully proscribe certain anticompetitive state acts while not interfering with the state's prerogative to govern; and discusses the normative implications of (more) antitrust coverage of state acts.

[19] Fox, 'State Action', 474.

culture and local political interests are readily expressed at the Member State level, the same cannot be said for participation at the EU level. In the US many citizens are active in elections for both the House of Representatives and the Senate, whereas the majority of residents of the EU appear to have little or no idea as to who represents them in the Europe Parliament or for that matter in the Council of Ministers.

While both the EU and the US federal systems can be improved with respect to antitrust enforcement, I am somewhat more sanguine about long-term prospects in the US. As I see it, the US system can be readily improved, through a combination of statutory and legal interventions. While great patience will be required, I see improvement as politically feasible. As has been noted, currently, the US courts require the answers to two questions: (1) is the regulation clearly articulated? (2) Is it actively supervised? If the answer to both is yes, the state action is exempt. I propose that the courts add a third question. Are there any interjurisdictional monopoly spillovers with the potential to significantly harm customers outside the state? If the answer to that question is yes, then there is no exemption. With the addition of this externality hurdle, a relatively weak (on efficiency grounds) state action doctrine can be transformed into one that can achieve both efficiency and participation goals.

As an alternative, the externality problem can be remedied through statutory action, action that would recognize the problems created by interjurisdictional spillovers in the current antitrust exemptions cases. Inman and I have offered one solution.[20] We suggest a detailed "spillover test" which the courts can use to identify those instances in which interjurisdictional economic harm may have been imposed on out-of-state residents without their prior political approval. If a state regulation fails the test, we argue it should be subject to Sherman Act review. Our proposed spillover test enhances overall economic efficiency in the regulatory economy and contributes to the goal of political participation. If this were to become law, either through the common law or through statutory intervention, I believe that the US federal system, one that is more mature than the European system both politically and economically, can provide a tool that allows us to determine the appropriate protections for active state policymaking, and can promote and protect a truly political process for setting regulatory policies.[21]

[20] Inman and Rubinfeld, 'Making Sense of the Antitrust State Action Doctrine'.

[21] A number of scholars, including Andrew Guzman and Eleanor Fox and Deborah Healey have discussed how the externality problem can best be handled by some form of international regulatory authority. Guzman believes that the regulation of international antitrust requires the adoption of substantive international standards and that the place to establish such standards is the World Trade Organization (WTO). See Andrew Guzman, 'Antitrust and International Regulatory Federalism' (2001), 76 *New York University Law Review* 142; Fox and Healey, 'When the State Harms Competition'. At this point in time, it appears that the WTO is unlikely to take on such a task. The more operative question is whether the current International Competition Network can be transformed into Professor Fox's ideal of a world competition forum.