CPI COMPETITION POLICY INTERNATIONAL

CPI Antitrust Chronicle
April 2014 (2)

North Carolina Dental: The Supreme Court and State Action Antitrust Immunity

Jane E. Willis & Amy D. Paul
Ropes & Gray LLP

www.competitionpolicyinternational.com

North Carolina Dental: The Supreme Court and State Action Antitrust Immunity

Jane E. Willis & Amy D. Paul[1]

I. INTRODUCTION

It is well-settled under Supreme Court precedent that antitrust immunity may apply when either (i) a state exercises its legislative authority by passing a regulation or (ii) an actor acts at the direction of the state, even if that action results in anticompetitive effects or harm to the competitive process.[2] A threshold question for application of state action immunity is whether the actor is a state (public) or private actor because this determination drives the level of scrutiny applied to the action at issue. While it may seem simple enough in principle, it is difficult in practice to determine, based on existing case law, whether certain committees or boards, although affiliated with and sanctioned by state and local governments, are public or private actors.

On March 3, 2014, the Supreme Court granted certiorari in the case of *North Carolina State Board of Dental Examiners v. Federal Trade Commission* ("*North Carolina Dental*").[3] As a result, the Supreme Court will have the opportunity to clarify the state action immunity doctrine, including whether an entity is a public or private actor, and provide guidance as to when conduct is exempt from antitrust scrutiny.

II. THE ISSUE: PRIVATE OR PUBLIC ACTOR?

Whether an entity is a public (state) or private actor determines whether a one-part or two-part test applies when determining state action immunity. In *California Retail Liquor Dealers Assn. v. Midcal Aluminum, Inc.*,[4] the Supreme Court created a two-part test "to determine whether anticompetitive conduct engaged in by private parties should be deemed state action and thus shielded from the antitrust laws."[5] First, "the challenged restraint must be one clearly articulated and affirmatively expressed as state policy."[6] Second, the conduct "must be actively supervised by the State itself."[7]

---

[1] The authors are, respectively, Partner and Associate in the litigation department of Ropes & Gray LLP.

[2] *See* Parker v. Brown, 317 U.S. 341, 351 (1943) (holding that the "Sherman Act makes no mention of the state as such, and gives no hint that it was intended to restrain state action or official action directed by a state").

[3] Case number 13-534, in the U.S. Supreme Court.

[4] 445 U.S. 97 (1980).

[5] Patrick v. Burget, 486 U.S. 94, 100 (1988) (citing *Midcal*).

[6] *Midcal*, 445 U.S. at 105 (internal citations omitted).

[7] *Id.*

If an actor is the state or a public actor, it needs only to satisfy the first prong, which it can do by identifying the state policy that clearly articulates its purpose is to displace competition.[8] The rationale for this reduced scrutiny stems from the comfort that public actors' conduct is "likely to be exposed to public scrutiny," and thus will be "checked to some degree through the electoral process."[9] Some entities such as counties, municipalities, and other substate government entities are deemed to be state actors and thus are not subject to the active state supervision requirement under *Midcal*.[10] When an actor is private, immunity will apply only if the actor can satisfy both *Midcal* prongs.

A. Background Facts

North Carolina Dental involves a board ("Board") that was statutorily created to regulate the practice of dentistry.[11] The eight-member Board is comprised of six licensed dentists, one licensed dental hygienist, and one consumer member. The dental members are elected by dentists; the hygienist member is elected by dental hygienists. The governor appoints the consumer member. Board members, other than the consumer member, are required to maintain an active dentistry practice while serving on the Board. Thus, a majority of the Board consists of dentists engaged in active practice, elected by other dentists. In addition to the issuance, denial, and revocation of dentistry licenses, it is also granted a broad power to "take other disciplinary measures against a licensee as it deem[ed] fit and proper."[12]

If the Board suspects that an individual is engaging in the unlicensed practice of dentistry, it is permitted to bring an action to enjoin the practice in North Carolina Superior Court or to refer the matter to the District Attorney for criminal prosecution.[13] It does not have the express authority to discipline unlicensed individuals or issue orders.

The case before the Supreme Court concerns the provision of teeth-whitening services. Both dentists and non-dentists provide these services, though non-dentists may do so at a significantly lower price than dentists. The Board opened an investigation into teeth-whitening services provided by non-dentists. As a result of its investigation, the Board took several actions, including sending 47 cease-and-desist letters to 29 non-dentists and sending letters to shopping mall operators encouraging them not to lease kiosk space to non-dentists providing these services. The Board's actions had the result of impeding non-dentists from providing these services and deterring suppliers of teeth-whitening products used by non-dentists from selling such products in North Carolina. These actions threatened the availability of teeth whitening services at reasonable prices to North Carolina consumers.

---

[8] How to determine whether the clear articulation prong has been satisfied is an issue that was decided by the Supreme Court in FTC v. Phoebe Putney Health System, Inc., 133 S. Ct. 1003 (2013). The Court held that a state's "grant of general corporate powers to [an actor] does not include permission to use those powers anticompetitively." *Id.* at 1007.

[9] Town of Hallie v. City of Eau Claire, 471 U.S. 34, 45 n.9 (1985).

[10] *See id.* (holding that municipalities must only satisfy the first prong) and *Phoebe Putney*, 133 S. Ct. at 1007 (finding that a state-sanctioned hospital authority was a substate government entity).

[11] N.C. GEN. STAT. § 90-29(b)(2).

[12] N.C. GEN. STAT. § 90-41.

[13] N.C. GEN. STAT. § 90-40.1.

B. The FTC's and the Fourth Circuit's Decisions

In 2011, the Federal Trade Commission ("FTC") issued a Decision and Order that the Board had illegally thwarted lower-priced competition by engaging in anticompetitive conduct to prevent non-dentists from providing teeth whitening services to consumers in the state. In analyzing whether the Board was a public or private actor, it held that the "operative factor" in determining whether a public-private hybrid entity,[14] such as a regulatory body like the Board, was required to meet the active supervision prong was the "degree of confidence that the entity's decision-making process is sufficiently independent from the interests of those being regulated," particularly financial interests.

The Fourth Circuit agreed with the FTC that because the majority of the Board was comprised of market participants (i.e., dentists), who were "chosen by and accountable to their fellow market participants," it was therefore a private actor subject to both *Midcal* prongs.[15]

The court then found that the Board could not satisfy the active supervision prong. The Board argued that certain reporting provisions and "good government" provisions under North Carolina law were evidence of active state supervision. The court disagreed, finding that this type of "generic oversight" was insufficient to satisfy the degree of required state review. Instead, the court held that because the Board sent the cease-and-desist letters without state oversight and without the required judicial authorization from the Superior Court, the active supervision prong could not be satisfied; therefore, the Board's actions were not entitled to antitrust immunity.

III. WHY THIS DECISION MATTERS

Both the Fourth Circuit's decision and the Supreme Court's grant of certiorari have generated considerable interest among the antitrust bar, as well as professionals and companies that participate in regulated industries. Depending on the Supreme Court's ruling, quasi-governmental boards across the country could be emboldened to take similar actions that may be anticompetitive, knowing that they have antitrust immunity just as if a state legislature itself had take the action. The result could be exclusion of competitors from an industry—as is alleged in *North Carolina Dental*—or higher prices, lower output, lower quality, or other reductions in competition.

Notably, this case will mark the second time in two years (*Phoebe Putney* being the first) that the Supreme Court has confronted the ambiguities surrounding state action antitrust immunity. The outcome in *North Carolina Dental* will shape and effect antitrust cases for years to come.

IV. THE SUPREME COURT GRANTED CERTIORARI

In its petition to the Supreme Court, the Board argued that the Fourth Circuit's decision created a "circuit split" on the issue of whether the Board is a state or private actor, and therefore whether a one-prong or two-prong test applies. The split is a result of the perceived tension between the Fourth Circuit's decision to require active supervision in this case and the Ninth and Fifth Circuits' declination to require active supervision in other cases. The Board argued that the

[14] The entity is both public and private because it is established by statute but comprised of private citizens.
[15] 717 F.3d 359, 368 (4th Cir. 2013).

Fourth Circuit's decision was contrary to these precedents, which establish the rule that a state entity's enforcement of an anticompetitive state policy is exempt from antitrust scrutiny—"without regard to the public officials' independence from private interests, method of selection, or supervision by other state entities."[16]

In *Earles v. State Bd. of Certified Public Accountants of Louisiana,*[17] the Fifth Circuit considered the status of Louisiana's state board of Certified Public Accountants ("CPAs"), which had promulgated rules prohibiting CPAs from carrying out their accounting practices while simultaneously selling securities. The court held that the board was a state actor "despite the fact that [it was] composed entirely of CPAs who compete in the profession they regulate," and thus exempt from the active supervision requirement. The court opined that the "public nature" of the board's actions would cause it to not act self-interestedly.

Hass v. Oregon State Bar[18] involved the Ninth Circuit applying the one-prong test to the Oregon State Bar based on several factors, including that there were non-lawyers on the board of governors, that the records were open for public inspection, and that its accounts were periodically audited by the state auditor. The Ninth Circuit took the view there was an electoral "check" on the actions of the board that would hold the board accountable at least to members of the profession.[19]

The grant of certiorari in *North Carolina Dental* comes only one year after the Supreme Court granted certiorari in *FTC v. Phoebe Putney Health System, Inc.*, 133 S. Ct. 1003 (2013). In that case, the Supreme Court decided that a hospital merger in Georgia previously approved by the county hospital authority was anticompetitive and the approval was not entitled to antitrust immunity. The justices voted unanimously that state action immunity applies only when the state legislature has a clearly articulated policy to displace competition and a state's grant of general corporate powers is insufficient to meet this standard.

Phoebe Putney did not provide the Court an opportunity to address the public versus private actor question because the FTC did not challenge the Eleventh Circuit's determination that hospital authorities qualified as "political subdivisions."[20] Given that it was not appropriate to address the issue in *Phoebe Putney*, the Supreme Court may have seen *North Carolina Dental* as the proper case to address this important component of the state action immunity doctrine.

V. HOW THE COURT WILL RULE

The Court's decision in *North Carolina Dental* may further provide guidance regarding the underlying question of whether the determination of state versus private actor is more of a bright-line test or a facts-and-circumstances test. In other words, are there some state-created entities (the Fourth Circuit calls these "quintessential state agencies") entitled to immunity

[16] Petition for Writ of Certiorari, North Carolina State Board of Dental Examiners v. Federal Trade Commission, at 10 (No. 13-534).

[17] 139 F.3d 1033 (5th Cir. 1998).

[18] 883 F.2d 1453 (9th Cir. 1989).

[19] *Hass*, 883 F.2d at 1460 & n.3.

[20] *Phoebe Putney*, 133 S. Ct. at 1011 n.5.

without a showing of active supervision, while others are not? If so, how does one determine what those "quintessential state agencies" are?

In *Town of Hallie v. City of Eau Claire*, the Supreme Court recognized immunity for municipalities—official sub-state entities—without a showing of active state supervision.[21] Without explicitly defining what entities—other than municipalities—may constitute state actors, the Court suggested that its rule may not be limited to municipalities. In a key footnote, the Court stated:

> In cases in which the actor is a state agency, it is likely that active state supervision would also not be required, although we do not here decide that issue. Where state or municipal regulation by a private party is involved, however, active state supervision must be shown, even where a clearly articulated state policy exists.[22]

The Board has urged the Court to expound on the footnote in *Hallie* and rule that state-created agencies, such as the Board, acting pursuant to their grant of power, are engaged in official conduct and, as subdivisions of the state or "substate entities," do not require active supervision. The State asks the Supreme Court to rule that, when dealing with official state agencies, a one-prong test applies, without consideration of how the agency members were selected. Given the facts and circumstances of *North Carolina Dental*, which point so heavily to the conclusion that the Board is a private actor (market participants elected by market participants with only one state-appointed member), a reversal of the Fourth Circuit's decision could well establish a bright-line rule that would insulate these types of boards from investigation by antitrust regulators and for liability for anticompetitive conduct. Such a ruling could, therefore, cause substantial adverse effects on consumers and the general public.

Alternatively, the Supreme Court could endorse a test like that proposed by the FTC, that turns on an inquiry into the facts and circumstances of the individual body, including the selection process for decision makers and to whom they are responsible, when determining whether a state agency or board is subject to antitrust scrutiny. Such an approach would likely result in an affirmance of the Fourth Circuit's decision.

Notably, in *Earles v. State Bd. of Certified Public Accountants of Louisiana*, the government had a greater hand in the selection of the board members. Pursuant to statute, the seven members of the board were chosen by the governor from a slate of candidates proposed by other accountants. Candidates were then confirmed by the state senate. In the original state action immunity case—*Parker v. Brown*—six of the nine members of the State Commission were required to be farmers, and thus were market participants, but the farmer members were appointed by the governor and confirmed by the state senate.[23] In light of these cases, the Supreme Court may agree with the Fourth Circuit that the process for selecting a board's members is relevant to the immunity inquiry. If so, the Court could distinguish the North Carolina Board from those in *Earles* and *Parker* and hold that, if a board's members are elected by market participants (without the intervening choice of state officials), then it is a private actor for purposes of antitrust immunity. This approach would seemingly accord with the holdings in

[21] 471 U.S. 34, 45-47 (1985).

[22] *Id*. at 46 n.10.

[23] The Commission was regulating the terms on which a commodity could be sold.

two other Supreme Court cases—*Midcal* and *Goldfarb v. Virginia State Bar*—both of which emphasized that when a state subdivision like a board has the characteristics of a private actor and takes actions that ostensibly benefit its own members, the two-prong test should apply.[24] This approach would protect consumers from actions by boards that are dominated by market participants whose conduct is unchecked.

VI. CONCLUSION

The fact that the Supreme Court granted certiorari in this case has resulted in substantial interest, not only from the antitrust bar but also from executives in various professions and industries across the country that are regulated by states in a similar manner. The decision will have an important effect not only on antitrust doctrine but also, more practically, on how government entities, such as professional boards, are governed and ultimately on how professions regulate themselves, as well as on how much authority such professional groups have to limit lower cost providers.

Professional licensing boards regulate nearly one-third of the U.S. workforce across 800 different occupations.[25] If the Supreme Court immunizes these boards' potentially anticompetitive actions, the market for these professional services may become skewed by self-interested participants, which will ultimately harm consumers.

[24] Goldfarb v. Virginia State Bar, 421 U.S. 773 (1975) concerned a minimum fee schedule for attorneys. The Supreme Court held this constituted price-fixing that was not immunized by state action because the State did not compel the minimum-fee schedule.

[25] *See* Aaron Edlin & Rebecca Haw, *Cartels By Another Name: Should Licensed Occupations Face Antitrust Scrutiny?*, U. PA. L. REV. (forthcoming 2014).