ANTITRUST PROCESS AND VERTICAL DEFERENCE:

JUDICIAL REVIEW OF STATE REGULATORY INACTION

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ABSTRACT

Courts struggle with the tension between national competition laws, on the one hand, and state and local regulation, on the other – especially as traditional governmental functions are privatized and as economic regulation advances beyond its traditional role to address market monitoring. This Article defends a process-based account of the state action antitrust exception against alternative interpretations, such as the substantive efficiency preemption approach recently advanced by Richard Squire, and elaborates on what such a process-based account would entail for courts addressing the role of state economic regulation as a defense in antitrust cases. It recasts the debate as focused around delegation issues and judicial deference to regulation – traditionally issues of administrative law. State action antitrust exception issues frequently are invoked where state officials fail to act or only act partially to regulate, as is increasingly common where states privatize governmental functions or attempt to deregulate, or implement competition policies of their own. As I shall argue, in such contexts a delegation model, which focuses on the conditions under which state legislative bodies have made delegations, whether agency regulators have standards, and the reasons provided by state and local officials for regulatory inaction, provides a more powerful and principled approach for evaluating the interaction between regulation and antitrust litigation than alternative approaches.

A process-based account of the state action exception recognizes federalism and efficiency as important values, but changes the primary emphasis of the judicial inquiry. Federalism values and economic efficiency may well be advanced by applications of the

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state action exception, but that does not require courts to ground their decisions in individual cases entirely on federal preemption legal analysis or on an assessment of the substantive efficiency of state or local regulation. On a process-based account, federalism goals could be advanced by state and local political processes as much as by federal courts attempting to identify and apply the substantive values in broad federal statutes such as the Sherman Act. Moreover, a process-based account of antitrust defenses, such as the state action exception, recognizes the possibility that economic efficiency can inform the application of the substantive standards of antitrust law without requiring economic efficiency to be the primary focus in evaluating every governmental program, particularly at the state and local level. By discouraging courts from directly addressing economic efficiency concerns before addressing the merits of an antitrust violation, such an approach promotes judicial economy and, if properly cabined, can also have a positive effect on the behavior of private groups in the lawmaking process. Even within alternative accounts that give priority to federalism or economic efficiency, the delegation approach should be used to inform the evidentiary assessment of procedure, serving as predicate any judicial decision to extend a state action antitrust exception.

The Article proceeds in four parts. Part I discusses the problems with current formulations and applications of the antitrust state action exception, which no one finds satisfactory. As I argue, traditional approaches, such as a federal preemption-oriented understanding of state action doctrine, have serious limitations given a state and local regulatory environment that is increasingly characterized by regulatory transition and inaction. Part II introduces *Chevron*, the predominant paradigm for judicial review of regulation in administrative law, highlighting its delegation structure and aspects of it that are useful to understanding the problems state regulation present for antitrust law. Part III explains limits to the analogy between *Chevron* step one and the clear articulation requirement for antitrust state action. Part IV draws an analogy to step two of *Chevron* and analyzes the implications of recasting the state action antitrust exception to focus on agency reasons, not power or history. The Article concludes by addressing the kinds of reasons that should suffice for purposes of addressing active regulatory supervision at the state and local level as a predicate to extending an antitrust state action exception.

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In adopting federal antitrust statutes, Congress has consistently failed to address how national competition rules will coexist with state or local regulation. Recognizing that Congress could not have intended blanket preemption of state or local regulation, the U.S. Supreme Court created an antitrust state action exception in *Parker v. Brown*, a 1943 case rejecting a Sherman Act challenge to a California raisin producer prorate marketing program brought by a grower because the program derived "its authority and its efficacy from the legislative command of the state."[1] Over recent decades courts have routinely invoked the state action exception to reject federal antitrust claims[2] – so much so that in early 2007 the Antitrust Modernization Commission included among its initial recommendations a finding that lower courts have interpreted the defense far too broadly,[3] echoing an earlier conclusion by the Federal Trade Commission.[4]

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[1] Parker v. Brown, 317 U.S. 341, 350 (1943).

[2] *See infra* notes 67-108 and accompanying text (describing cases from the Eighth, Tenth and Eleventh Circuits); *infra* notes 39-44 and notes 213-15 and accompanying text (describing U.S. Supreme Court missteps).

[3] *See* Antitrust Modernization Commission, *Tentative Recommendations for January 11, 2007 Meeting*, available at http://www.amc.gov/pdf/meetings/list_of_recommendations_jan_11v3.pdf. The Antitrust Modernization Commission was created by Congress in 2002 to study the need for and to submit proposals to modernize federal antitrust law. Pub. L. 107-273, 116 Stat. 1758 (November 2, 2002).

[4] A 2003 Federal Trade Commission report concludes that courts rely too heavily on the doctrine and "the state action doctrine has come to pose a serious impediment to

While *Parker* was born of an "era of exceptional confidence in government,"[5] skepticism about regulation and the process from which it evolves has grown. For example, public choice theory highlights how the incentives surrounding the lawmaking process diverge from the public interest where state and local regulation are at issue.[6] Recognizing such concerns, the modern doctrinal test for the antitrust state action exception, derived from *California Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc.*[7] (*Midcal*), places its primary focus on the delegation issue faced by a state legislature in adopting a regulatory program. First, a court asks whether a state sovereign lawmaking body (i.e., a legislature) has clearly articulated a policy to allow the allegedly anticompetitive conduct. Second, a court asks whether the governmental entity to whom authority has been delegated actively supervises the private conduct at issue.[8]

While delegation concerns seem central to the basic state action exception doctrine expressed in *Midcal*, attention to delegation issues is largely foreign to the predominant judicial applications of the doctrine as well as to academic accounts. Instead, the predominant accounts of the antitrust state action exception ground its purposes in federalism (or preemption based on substantive economic efficiency) – a

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achieving national competition policy goals."*See* REPORT OF THE STATE ACTION TASK FORCE 25 (September 2003) (by Todd J. Zywicki, Director of the FTC Office of Policy Planning) [hereinafter FTC STATE ACTION REPORT], available at http://www.ftc.gov/os/2003/09/stateactionreport.pdf.

[5] John T. Delacourt & Todd J. Zywicki, *The FTC and State Action: Evolving Views on the Proper Role of Government*, 72 ANTITRUST L.J. 1075 (2005).

[6] For discussions, see *infra* text following note 45 (discussing how, as Madison recognized in Federalist No. 10, concerns with interest group exploitation are heightened the more local the lawmaking process).

[7] California Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc. 455 U.S. 97 (1980).

[8] *Id.* at 105.

view advanced by Frank Easterbrook[9] and, more recently, Richard Squire[10] − or on a more policy-oriented balance between markets and regulation − advocated by scholars such as Daniel Gifford.[11] In contrast, Einer Elhauge has proposed to understand the antitrust state action exception through a political "process-based" lens – an account that has much abstract appeal but has not exactly resulted in useful practical wisdom for courts in the fifteen years since its articulation.[12]

This Article urges a fundamental reorientation of state action doctrine in antitrust law. I defend a process-based account of the state action exception against alternative interpretations, such as the substantive efficiency preemption approach recently advanced by commentators such as Squire, and elaborate on what such a process-based account would entail for courts addressing the role of state economic regulation as a defense in antitrust cases. In doing so, I recast the debate as focused around delegation issues and judicial deference to regulation – traditionally issues of administrative law. State action antitrust exception issues frequently are invoked where state officials fail to act or only

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[9] *See* Frank H. Easterbrook, *Antitrust and the Economics of Federalism*, 26 J. LAW & ECON. 23 (1983) (emphasizing federalism aspects of the antitrust state action exception).

[10] Richard Squire argues that federal preemption principles should entirely "replace" the state action exception in antitrust law. Richard Squire, *Antitrust and the Supremacy Clause*, 59 STAN. L. REV. 77, 79 (2006) (proposing to frame the state action exception entirely in federal preemption terms).

[11] *See* Daniel J. Gifford, *Federalism, Efficiency, the Commerce Clause, and the Sherman Act: Why We Should Follow a Consistent Free Market Policy*, 44 EMORY L.J. 1227 (1995) (placing the antitrust emphasis on striking the balance between markets and regulation). Increasingly, antitrust law and regulation are converging to present new doctrinal challenges for courts. *See* Reza Dibadj, *Saving Antitrust*, 75 U. COLO. L. REV. 745, 747 (2004) (arguing that "as economic regulation has evolved it no longer makes sense to treat antitrust and regulation as separate bodies of doctrine--unified, they should form the building blocks of a new competition law.").

[12] Einer Richard Elhauge, *The Scope of Antitrust Process*, 104 HARV. L. REV. 667 (1991) (stating "the Court should recognize the process view that actually underlies its doctrine and, if it is going to decide cases based on that view, explicitly incorporate it into a rule of decision that better explains and fits its case law.").

act partially to regulate (as is increasingly common where states privatize governmental functions), implement industry-wide settlements (as in the context of the tobacco industry), or attempt to implement competition policies of their own (as is commonly referred to as "deregulation"). As I shall argue, in such contexts a delegation model, which focuses on the conditions under which state legislative bodies have made delegations, whether regulators have standards, and the reasons provided by state and local officials for regulatory inaction, provides a more powerful and principled approach for evaluating the interaction between regulation and antitrust litigation than alternative approaches. In making a decision to extend the state action exception, a federal court is allowing a state legislature to delegate to state regulators the discretion to opt out of federal antitrust laws. Of course, courts are willing to allow federal agencies to exercise discretion pursuant to broad legislative delegations, but typically only when subject to judicial review for reasonableness. By an analogy, it is entirely appropriate, and normatively desirable, for a federal court to impose a similar condition on state legislative delegations to a state agency, subjecting these to arbitrary and capricious review prior to suspending national competition laws.

The delegation-based approach to this question leaves room for federal courts to defer to traditional state regulatory schemes, such as cost-of-service regulation. It also challenges courts confronted with new regulatory approaches to develop a more nuanced approach to deciding the extent to which federal law – in particular, the Sherman Act – preempts state regulation.[13] A process-based account of the state action exception

[13] For the general argument that the issue of state action exception under the antitrust laws is a type of federal preemption inquiry, see Squire, *supra* note 10. Squire's argument understands the judicial decision to extend a state action antitrust exemption as

recognizes federalism and efficiency as important values, but changes the primary emphasis of the judicial inquiry. Federalism values and economic efficiency may well be advanced by applications of the state action exception, but that does not require courts to ground their decisions in individual cases entirely on federal preemption legal analysis or on an assessment of the substantive efficiency of state or local regulation. On a process-based account, federalism goals could be advanced by state and local political processes as much as by federal courts attempting to identify and apply the substantive values in broad federal statutes such as the Sherman Act. Moreover, a process-based account of antitrust defenses, such as the state action exception, recognizes the possibility that economic efficiency can inform the application of the substantive standards of antitrust law without requiring economic efficiency to be the primary focus in evaluating every governmental program, particularly at the state and local level.[14] By discouraging courts from directly addressing economic efficiency concerns before addressing the merits of an antitrust violation, such an approach promotes judicial economy and, if properly cabined, can also have a positive effect on the behavior of private groups in the lawmaking process. Even within alternative accounts that give priority to federalism or economic efficiency, the delegation approach should be used to inform the evidentiary assessment

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based on an assessment of articulated and unarticulated substantive regulatory goals at the state level and their conflict with federal antitrust law goals. However, consistent with the application of *Chevron* to federal agencies, my approach focuses primarily on state regulators' processes and pre-articulated reasons for their decisions, not their substantive regulatory goals as determined by federal courts. Further, my approach does not propose to replace the state action exception with a federal preemption inquiry, but to refine its application. Thus, to the extent my approach is preemption-oriented, it is a process-based preemption approach.

[14] There is substantial evidence that the framers of the Sherman Act, who were willing to allow many inefficient state and local regulations to stand, simply did not have powerful substantive definitions of efficiency in mind as a basis for preempting state or local regulation. *See infra* notes 53-59 and accompanying text.

of procedure, serving as predicate to any judicial decision to extend a state action antitrust exception.

At its core, the state action antitrust exception focuses on the conditions under which it is appropriate for federal courts to defer to state regulators – a kind of vertical deference in antitrust law. However, antitrust law and scholarship ignore that administrative law has its own well-settled approach to determining when it is appropriate for a federal court to defer to federal regulators – a type of horizontal deference. The *Chevron* test provides the predominant paradigm for federal courts reviewing matters of agency statutory interpretation. In applying the *Chevron* test, a court will typically engage in a two-part inquiry: first, a court asks whether a statute is clear and unambiguous in addressing the issue in question; second, to the extent a court deems to the statute to be unclear or ambiguous, the court typically defers to an agency's reasonable interpretation under the statute.[15] In contrast to *Midcal's* approach to the state action antitrust doctrine, in addressing deference issues under *Chevron* a court does not always get to the second inquiry. However, where a statute is ambiguous, the *Chevron* step two inquiry – deference to an agency's reasoned interpretation − is generally appropriate.[16] While an appeal to *Chevron* deference alone provides an unsatisfactory (and, in my view, impoverished) way of thinking about vertical deference issues in antitrust law,[17] an emphasis on delegation issues at *Chevron's* step two, and especially

[15] Chevron USA, Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837, 842-43 (1984).
[16] *Id.* at 843-44.
[17] There are, for example, those who argue from both the left and the right for strong deference at step two of *Chevron* as recognizing the constitutional values of the unitary executive. *See, e.g.,* Elena Kagan, *Presidential Administration*, 114 HARV. L. REV. 2245, 2251 (2001) (arguing that delegation to agency officials authorizes the President to

the presence of standards to constrain and guide the exercise of discretion, provides a particularly powerful set of guideposts for addressing state action exception cases.[18]

First, a delegation-oriented approach to state action doctrine helps courts to focus on the core process questions at issue in evaluating whether a state legislative body has a clearly articulated policy in making the delegation, if any. As I shall argue, *Midcal's* clear articulation requirement, like step one of *Chevron*, can be framed as a type of penalty default rule designed to promote clarity in lawmaking and to deter interest groups from promoting, and lawmakers from adopting, ambiguous laws that purport to make excessively broad delegations to regulators. In applying *Midcal*, many courts extending the state action exception have expansively interpreted state and local statutes – making their own determinations of whether acceptance of anticompetitive conduct is required by regulators or may have been foreseen by lawmakers in making a delegation. A

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manage executive interpretations); Thomas W. Merrill, *Judicial Deference to Executive Precedent*, 101 YALE L.J. 969, n44 (1992) (claiming that "*Chevron's* democratic theory thesis appears to presuppose a unitary executive, i.e., an interpretation of separation of powers that would place all entities engaged in the execution of the law-including the so-called independent regulatory agencies-under Presidential control."); Michael Stokes Paulsen, *The Most Dangerous Branch: Executive Power to Say What the Law Is*, 83 GEO. L.J. 217, 333-35 (1994) (arguing that the unitary executive approach to *Chevron*, which would entitle the President's interpretation of laws to the greatest deference, is the better interpretation).

[18] For a discussion of the delegation-based approach to *Chevron*, see Lisa Schultz Bressman, *Disciplining Delegation After* Whitman v. American Trucking Ass'n, 87 CORNELL L. REV. 452 (2002) (suggesting that there are strong public choice rationales for requiring administrative standards in arbitrary and capricious review to address delegation-oriented concerns); Kevin M. Stack, *The President's Statutory Powers to Administer the Law*, 106 COLUM. L. REV. 263 (2006) (arguing that *Chevron* deference only extends to specifically assigned agency delegations, not to general delegations to the executive branch); *see also* Evan Criddle, *Fiduciary Foundation of Administrative Law*, 54 UCLA L. REV. 117, 153 (2006) (arguing that, like corporate law's emphasis on fiduciary duties, administrative law, including *Chevron*, "calls upon courts to enforce agency duties in order to promote fidelity to agencies' statutorily defined missions and the best interests of their beneficiaries.").

delegation-oriented approach to state action doctrine warns federal courts against aggressively attributing purposes to state and local legislative delegations, particularly to the extent this encourages adverse levels of interest group lobbying in the state legislative process as a way of opting out of federal antitrust enforcement.

Second, such an approach to state action doctrine views the evaluation of active supervision by state regulators (the second prong of *Midcal*) as a necessary evaluation of the reasons given by regulators − not as some sort of dispensable judicial test, or as an inquiry into mere agency power (i.e., whether the agency has jurisdiction) or history (i.e., what specific actions a regulator has taken in the past). The core prescriptive recommendation is to frame active supervision as focusing not on power/jurisdiction or history/action per se, but on the nature and sufficiency of the reasons given by the regulator (akin to arbitrary and capricious review under *Chevron* step two). Unlike judicial application of *Chevron* step-two deference in reviewing a federal agency, however, I argue that where there is a state legislative delegation to an agency in the antitrust context a court should always apply something more than mere deference and should review the regulator's decisions for transparency, consistency, and pre-articulated criteria. Indeed, the arguments for a delegation-based approach to deference are stronger in the context of vertical deference than in the context of federal courts reviewing federal agencies. Given the specific interest group pathologies at issue in state and local political processes, and especially those large regulated firms are likely to exploit, the state action exception presents a more serious type of institutional problem than judicial review of the run-of-the-mill federal agency. Such public choice concerns are less salient, and generally advise stronger deference to a regulator, when a court is reviewing a federal

agency's interpretation of law under *Chevron* – even in instances where federalism issues are raised − because it is more difficult for private interest groups to exploit federal as opposed to state and local regulatory processes.[19]

This Article proceeds in four parts. Part I discusses the problems with current formulations and applications of the antitrust state action exception, which no one finds satisfactory. As I argue, traditional approaches, such as a federal preemption-oriented understanding of state action doctrine, have serious limitations given a state and local regulatory environment that is increasingly characterized by regulatory transition and inaction. Part II introduces *Chevron*, the predominant paradigm for judicial review of regulation in administrative law, highlighting its delegation structure and aspects of it that are useful to understanding the problems state regulation present for antitrust law. Part III explains limits to the analogy between *Chevron* step one and the clear articulation requirement for antitrust state action. Part IV draws an analogy to step two of *Chevron* and analyzes the implications of recasting the state action antitrust exception to focus on agency reasons, not power or history. The Article concludes by addressing the kinds of reasons should suffice for purposes of addressing active regulatory supervision at the state and local level as a predicate to extending an antitrust state action exception.

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[19] Phil Weiser has suggested that federal courts apply *Chevron* deference to the decisions of state regulators applying the Telecommunications Act of 1996. Philip J. Weiser, Chevron, *Cooperative Federalism and Telecommunications Reform*, 52 VAND. L. REV. 1 (1999). Weiser's analysis focuses on the extent to which federal courts should defer to a state regulator's decision regarding the meaning of federal law. By contrast, in this Article I focus on the extent to which federal courts should defer to state regulators applying state law against the backdrop of the Sherman Act. As I suggest below, whatever lessons one takes from *Chevron* in the context of the antitrust state action exception, strong deference for state regulators should not be the primary one.

While courts applying the antitrust state action exception have largely ignored reasons provided by state regulators, attention to reasoned decisionmaking holds promise to advance the accountability of state regulation − particularly where state regulatory decisions are intermittent or are focused on disclosure and monitoring, rather than routine regulatory oversight. The Article concludes by elaborating on the kinds of reasons state or local regulators would need to provide prior to a court extending the state action antitrust exception where a regulator bans competition outright, where regulatory intervention is intermittent (such as in the context of market-based rates), or where regulation focuses on disclosure and monitoring. Emphasizing such accountability in the state action antitrust exception context, I conclude, is not only desirable, but is consistent with the broader goals of antitrust law and superior to alternative accounts.

I. ANTITRUST FEDERALISM AND VERTICAL DEFERENCE TO STATE AND LOCAL REGULATION

Congress clearly has the power to preempt state regulation in adopting national competition policy laws, such as the Sherman Act. However, in first recognizing the antitrust state action exception[20] in *Parker v. Brown,*[21] the Supreme Court acknowledged Congress had failed to preempt state law:

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[20] Although a number of courts and commentators refer to "state action immunity" or the "state action exemption," I eschew these labels to the defense. "Immunity" implies that the same defense would apply to all firms within a single regulatory program, but that approach the defense loses its generality as the nature of regulation varies between firms, as it increasingly does in industries undergoing change. In addition, the term "exemption" implies permanence to the decision to suspend antitrust laws, but changes in regulation in the same regulatory program or involving the same firm may necessitate changes in an antitrust defense. Hence, throughout this Article I prefer the term "state action exception."

[21] 317 U.S. 341 (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, 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.[22]

The approach of *Parker* treats a state legislative body as a "sovereign,"[23] presumptively allowing it to regulate private conduct as it sees fit.

But the presumption of legitimacy the antitrust laws afford state regulation is hardly absolute. *Parker* also left open the possibility that state regulation could, in some instances, allow firms to engage in conduct that runs afoul of the Sherman Act. For instance, a state cannot "give immunity to those who violate the Sherman Act by authorizing them to violate it, or by declaring that their action is lawful . . . ."[24] Significantly, the Court in *Parker* noted, in delegating its regulatory program the California legislature had established an extensive regulatory apparatus, including a public approval process and an enforcement mechanism:

> It is the state which has created the machinery for establishing the prorate program. Although the organization of a prorate zone is proposed by producers, and a prorate program, approved by the Commission, must also be approved by referendum of producers, it is the state, acting through the Commission, which adopts the program and which enforces it with penal sanctions, in the execution of a governmental policy.[25]

As *Parker* suggests, the state action antitrust exception first serves as a "filter" for judicial scrutiny of private conduct,[26] furthering the federalism purpose of facilitating

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[22] *Id.* at 350-51.
[23] *Id.*
[24] *Id.* at 351.
[25] Id at 352.
[26] Frank H. Easterbrook, *The Limits of Antitrust*, 63 TEX. L. REV. 1, 39 (1984) (arguing that antitrust law should design filters "to screen out beneficent conduct and pass only practices that are likely to reduce output and increase price" and that it is necessary for

participation in the state regulatory process[27] and, consequently, lending legitimacy to the development of regulation.[28] Following the approach of *Parker,* which embraces a general presumption against preemption of state regulation under the Sherman Act, federal courts have frequently embraced strong judicial deference to state and local regulation in the state action context.[29]

A. Preemption, Delegation and *Midcal*

Parker embraced deference to state regulation on the rationale that the Sherman Act did not preempt the state's regulatory approach. An important recent article by Richard Squire argues that state action issues in antitrust cases can be understood entirely through the lens of the Supremacy Clause of the U.S. Constitution.[30] Squire argues that federal preemption concerns should "replace" the state action exception.[31] An extension of a state action antitrust exception is at core a refusal to extend federal preemption to

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courts to "establish rules, recognizing that one cost of decision by rule is occasional over- and under-breadth").

[27] *See* Robert P. Inman & Daniel L. Rubinfeld, *Making Sense of the Antitrust State-Action Doctrine: Balancing Political Participation and Economic Efficiency in Regulatory Federalism*, 75 TEX. L. REV. 1203 (1997).

[28] The state action exception may also serve a judicial avoidance purpose, providing federal courts a way of disposing of complex and technical issues without having a binding impact on state law. However, other legal doctrines, such as abstention (which advises federal courts to abstain from exercising jurisdiction out of comity), adequately protect the precedent-creating risk of direct federal court review of state regulation. City of Chicago v. Int'l College of Surgeons, 533 U.S. 156 (1997) (allowing federal court review of state regulatory law claims, notwithstanding that state law provided for deferential review, but leaving open possibility of a lower court applying abstention principles). Abstention can be invoked where a federal court is making a decision that has a binding effect on state law. By contrast, with antitrust litigation courts are not normally passing judgments on the merits of state regulation, but are focused on the merits of private conduct under federal law.

[29] This strong deference to state and local regulation is observed in the recent FTC analysis of the state action exception. FTC STATE ACTION REPORT, *supra* note 4, at 2.

[30] Squire, *supra* note 10.

[31] *Id.* at 79.

state regulation. As *Parker* made clear, however, states were not afforded a carte blanche to override the Sherman Act, although the case failed to provide a workable standard for determining when state laws were impermissible.[32] For the first thirty five years of its existence, the state action exception was interpreted so as to allow a virtual type of state sovereign immunity, in which courts strongly deferred to state legislatures and regulators.

Beginning in the 1980's, however, the Supreme Court approved a more skeptical stance toward state and local regulation in antitrust law, questioning the deferential approach of *Parker*. In *Midcal*, the Court refused to extend the state action exception to California's wine pricing scheme, which did not involve anything more than passive approval of prices. In reaching this conclusion, *Midcal* articulated a two-part test to assist modern courts evaluating antitrust claims involving state regulation: "First, the challenged restraint must be 'one clearly articulated and affirmatively expressed as the state policy'; second, the policy must be 'actively supervised' by the state itself."[33] This test seems simple enough. Only if a state legislature expressly envisions monopolistic conduct and delegates authority to a governmental body to actively supervise such conduct will the conduct escape antitrust enforcement. A court must be satisfied that both parts of the test have been met before extending the state action exception in an antitrust claim.

In application, though, courts have struggled with state action antitrust doctrine, often because within a state different institutions take on various regulatory roles, and the nature of regulation varies so much from industry to industry. While the state action

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[32] *See supra* notes 21-25 and accompanying text.

[33] California Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc. 455 U.S. 97, 105 (1980) (citation omitted).

exception might be intended to create a safe harbor for state or local political and regulatory processes, displacing courts as overseers of private monopolistic conduct, the judicial decisions addressing state action doctrine are hardly consistent or principled. The Supreme Court's current approach to state action antitrust doctrine also seems to ignore how judicial deference in this context can increase incentives for rent seeking in ways that may prove harmful to social welfare in the state and local lawmaking process.

The application of the state action exception in the context of local governments (such as municipal bodies) as opposed to states highlights the current judicial misadventure with the doctrine.[34] In a short-lived line of cases the Supreme Court read state action doctrine narrowly in the context of municipal (as opposed to state) regulation. *Community Communications Co. v. City of Boulder*[35] subjected municipal governments to antitrust enforcement for monopolistic conduct. Speaking for the majority, Justice Brennan distinguished between states regulating as states – entitled to the state action defense under a federalism rationale – and political subdivisions – exempt from antitrust enforcement only insofar as they are implementing state policy, but not when they are acting as municipal governments only.[36] The City of Boulder's moratorium on cable

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[34] Commentary on the applicability of state action immunity to local governments is robust. *See, e.g.*, John Cirace, *An Economic Analysis of the "State Municipal Action" Antitrust Cases*, 61 TEX. L. REV. 481 (1982); Frank H. Easterbrook, *supra* note 9 (*Antitrust and the Economics of Federalism*); Glen O. Robinson, *The Sherman Act as a Home Rule Charter*: Community Communications Co. v. City of Boulder, 2 S. CT. ECON. REV. 131 (1983); Dan J. Gifford, *The Antitrust State-Action Doctrine After* Fisher v. Berkeley, 39 VAND. L. REV. 1257 (1986); Herbert Hovenkamp & John A Mackerron, *Municipal Regulation and Federal Antitrust Policy*, 32 UCLA L. REV. 719 (1985); John E. Lopatka, *State Action and Municipal Antitrust Immunity: An Economic Approach*, 53 FORDHAM L. REV. 23 (1984); C. Paul Rogers, *Municipal Antitrust Liability in a Federalist System*, 1980 ARIZ. ST. L. REV. 305.

[35] 455 U.S. 40 (1982).

[36] *Id*. at 52-53.

television expansion was thus subject to antitrust challenge because Colorado, at the state level, had not clearly expressed a policy to regulate cable television; in fact, Justice Brennan thought it apparent that Colorado had no state-wide policy at all – that there was a suspicious gap in state regulation.[37] *City of Boulder* correctly recognized that a reluctance to extend the state action exception from antitrust enforcement is justified in the context of municipal regulation, given the higher propensity for interest group exploitation of local, as opposed to state-wide, legislative processes.[38]

A more recent line cases, however, departs from the municipal-state distinction in that Justice Brennan laid down in the context of cable television regulation. In *Town of Hallie v. City of Eau Claire*, the Court abandoned the clear-articulation requirement in assessing municipal state action immunity.[39] Instead, Justice Powell reasoned in his majority opinion, so long as a state confers permissive authority in general terms for a municipality to deal with a matter in the municipal government discretion this suffices to exclude the conduct from antitrust enforcement. Thus, when the state of Wisconsin granted municipalities the authority to establish sewage treatment plants, this impliedly granted municipal government the power to make decisions about who would be served. Justice Powell recognized that municipalities may exercise "purely parochial public

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[37] *Id*. at 54-55. Justice Brennan was clear that "mere *neutrality*" (emphasis in original) by the state regarding municipal regulation does not suffice. Instead, a "clear articulation and affirmative expression" to replace antitrust enforcement with regulation is necessary. *Id*. at 55.

[38] Reacting to the prospect of liability created by the *City of Boulder* case, Congress abolished money damage liability under the antitrust laws for municipalities, their officials, and private persons acting under the direction of local governments and their officials in the Local Government Antitrust Act of 1984. *See* H.R. Rep. No. 965, 98th Cong., 2d Sess. 2, 18-19 (1984), *reprinted in* 5 U.S.C.C.A.N. 4602, 4619-20 (1984). Congress continued, however, to authorize antitrust liability for private conduct that is sanctioned or authorized by municipal governments.

[39] 471 U.S. 34 (1985).

interests" which, at some level, could be subject to antitrust enforcement.[40] However, in his view a state delegation to a municipal government alone is sufficient to meet the "clearly expressed and fully articulated" criterion of state action antitrust doctrine, thus exempting from antitrust enforcement a large range of municipal regulation. Under this approach, an "express mention" by a legislature of its intent to displace competition is not necessary (although perhaps it would be sufficient); instead, the Court suggests, what matters is that the allegedly anticompetitive conduct is a "foreseeable result" of the state policy.[41]

In addition, at least in the original *Midcal* formulation, state action doctrine requires courts to determine how active and involved a regulatory scheme must be for purposes of deeming it "active supervision." In the *Hallie* case, however, the Supreme Court effectively abandoned the requirement of active state supervision, at least insofar as it applies to municipalities.[42] In so holding, the Court explained that the purpose of the state supervision is to ensure that regulatory policies are pursued for public purposes and not to enrich private actors. According to the Court, "Where a private party is engaging in the anticompetitive activity, there is a real danger that he is acting to further his own interests rather than the government interests of the state."[43] But, if a state has clearly authorized a municipality to act, the Court reasoned that there is no such problem. Instead, the "only real danger is that it will seek to further purely parochial public interests at the expense of more overriding state goals."[44] Thus, if some clear state

[40] *Id*. at 42-43.
[41] *Id*. at 41-42.
[42] *Id*. at 46-47.
[43] *Id*.
[44] *Id*.

authorization exists, either expressly or by virtue of foreseeable results, the Court held that there is no need to make a finding that the state actively supervises the municipality's regulation of the private activity.

While this approach envisions some judicial inquiry into the "foreseeable results" of policy adopted by a state legislative body, the Supreme Court has never defined exactly what such a divining of legislative intent would entail.[45] Appellate courts following this approach frequently invoke the state action exception based almost exclusively on a clear legislative purpose, or a clear statement to allow the allegedly anticompetitive conduct. Beyond this, however, they generally engage in judicial restraint, deferring to state regulation of public utility monopolies under the antitrust laws. Agency deference has some inevitable appeal in a complex regulatory environment, but the Court's relaxation of a state supervision requirement for municipalities is counterintuitive if not incoherent. Since Madison's Federalist No. 10, it has been recognized that state and local political processes are more susceptible to interest group exploitation than their federal counterpart. The premise that municipal regulation is not likely to be exploited by private interests at the expense of the public good ignores the high risk of interest group rent seeking at the local level, where the incentives for ex ante lobbying of the regulator are perhaps strongest. At the local level, the costs to firms of organizing and lobbying regulators are much lower than at the state level; in addition, at the state and local level, extreme interest groups are more likely to hold influence, while at the national level extreme groups are more likely to cancel each

[45] For a discussion of this aspect of *Hallie*, see Elizabeth Trujillo**,** *State Action Antitrust Exemption Collides with Deregulation: Rehabilitating the Foreseeability Doctrine*, 11 FORDHAM J. CORP. & FIN. L. 349 (2006).

other out. Although the Court seems to embrace a federalism-based formalism as a rationale for deference to municipal regulation, this account of federalism proves too much. It can result in state delegation to municipal governments with no strings attached, insulating private behavior at the local level from almost all antitrust enforcement. Further, it places focus on the mere formalistic articulation of state goals by a state body, without addressing their purpose. States, as well as municipal governments, sometimes regulate in ways that allow private interests to place their own economic well-being ahead of the public good. Allowing the law to insulate such private conduct from antitrust scrutiny may have serious consequences, especially in deregulated markets where municipal utilities providing electric, gas, telephone and cable service can readily subvert competition policies with little or no scrutiny.

The Court's state action exception cases in the context of municipal regulation view the clear-articulation and active-supervision requirements as converging into a one-step foreseeability test, in which the judicial role is focused on divining legislative intent. Fortunately, a more recent case on the topic clarifies that the active-supervision requirement is alive and well as an independent criterion where what is at issue is the conduct of state, as opposed to municipal, regulators − although the Court's decision also raises many questions about the scope of the application of this market to many private arrangements in deregulated markets. In *FTC v. Ticor Title Insurance Co*. the Court addressed the extension of the state action exception to the rate setting activities of title insurance companies in several states.[46] Most of the states regulating the title insurance defendants permitted private insurers to jointly file rates, which state officials could

[46] 504 U.S. 621 (1992).

review or allow to remain in effect.[47] The record of the case suggested that no significant review of the rates actually took place by these states.[48] The FTC had conceded that the state statutes authorizing the acceptance of jointly filed rates met the clear-articulation requirement,[49] but the also Court found the agency's review did not constitute active supervision and thus failed the second step of *Midcal*.[50] Hence, the Court concluded, the allegedly anticompetitive acts of the insurers could be challenged.

The preemption recently advanced by Squire attempts to explain these and other cases as courts interpreting the Sherman Act to preempt the state regulatory program where the state approach seeks to confer monopoly profits on market participants by constricting output. His approach would replace an independent state action antitrust exception with an inquiry into preemption that hinges on a federal court's determination of the costs a state chooses to incur under state law. As Squire explains:

> a state which takes control over market prices incurs costs the state could avoid if its only goal were to confer monopoly profits on producers. These costs are pricing distortions, higher administrative expenses, and constituency protest. A state's willingness to incur these costs thus suggests that the state's regulatory objectives do not clash with federal antirust policy. My proposed preemption doctrine therefore allows states to suspend price competition among producers if the state also steps in to set market prices.[51]

Squire's substantive preemption approach, which emphasizes the costs a state chooses to incur in its regulatory approach, provides a tidy explanation for why private conduct

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[47] *Id*. at 629-31.
[48] In Wisconsin, for example, no rate hearings had occurred. *Id*.
[49] *Id*. at 631. In the decision below the Third Circuit, following a First Circuit decision, held that the existence of a funded and authorized state program met the active-supervision requirement. Ticor Title Insurance Co. v. FTC, 922 F.2d 1122, 1140 (3rd Cir. 1991), *following* New England Motor Rate Bureau, Inc. v. FTC, 908 F.2d 1064, 1071 (1st Cir. 1990).
[50] 504 U.S. at 640.
[51] Squire, *supra* note 10, at 79.

sanctioned under traditional state price regulation – such as franchise and cost-of-service regulation of electric utilities – is generally not subject to antitrust attack. His analysis would focus state action antitrust exception analysis entirely on whether a regulatory regime's objectives conflict with the purposes of the Sherman Act; where they do, federal preemption – and antitrust enforcement – is appropriate. His approach also implicitly assumes that the Sherman Act should be interpreted broadly given the public interest goal of protecting competition; hence, the presumption endorsed by Squire's approach in generally in favor of preemption.[52]

The substantive preemption approach may have some traction in explaining some of the twentieth century cases, but it is problematic in two main respects. First, it assumes that in passing the Sherman Act, Congress intended that state and local regulation be understood as imposing costs. There is no single, fixed meaning to the open-ended terms of the Sherman Act. Congress was focused on a wide range of broad goals in adopting the Sherman Act, including economic efficiency,[53] protecting consumer welfare,[54] preserving competition,[55] and protecting the political process from dominance by large corporate interests.[56] However, there is no evidence that Congress adopted such a strong efficiency understanding of antitrust enforcement in the Sherman Act that would

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[52] As Squire states, "the required limitations must reflect the Act's general purpose to prevent marketplace wealth transfers from consumers to producers, and yet must honor Congress's additional mandate that rules of antitrust be more deferential to state lawmakers than they are to market participants." Id at 107.
[53] *See, e.g.,* ROBERT BORK, THE ANTITRUST PARADOX 90-91, 110-12 (1978).
[54] *See, e.g.,* Robert H. Land, *Wealth Transfers as the Original and Primary Concern of Antitrust: The Efficiency Interpretation Challenged*, 34 HAST. L.J. 65 (1982).
[55] HERBERT HOVENKAMP, THE ANTITRUST ENTERPRISE: PRINCIPLE AND EXECUTION 42 (2005).
[56] *See, e.g.,* Robert Pitofsky, *The Political Content of Antitrust*, 127 U. PA. L. REV. 1051, 1053-58 (1979).

condemn state regulation of a wide range of activities at the time as problematic in any way – especially based on its costs. There is substantial evidence, by contrast, that Congress intended to leave in place a broad range of state regulation and to leave the evaluation of the appropriateness of future state and local regulation to the courts.[57] At the time Congress adopted the Sherman Act, state and local governments widely accepted regulation of a variety of private activities, including grain rate setting, bridge tolls, sewage regulation, railroad regulation, and other regulatory approaches than ranged from bans on prostitution to state and local taxes and rent control. There is also substantial evidence that the drafters and primary sponsors of the Sherman Act were focused primarily on the evil of the pursuit of "greed" by the few at the expense of the many. According to Senator Hoar, a member of the Judiciary Committee that drafted the final version of the Sherman Act:

> When . . . we are dealing with one of . . . the combinations aimed at chiefly by this bill, we are dealing with a transaction the only purpose of which is to extort from the community, monopolize, segregate, and apply to individual use, for the purposes of individual greed, wealth which ought properly and lawfully and for the public interest to be generally diffused over the whole community.[58]

As Elhauge has indicated in his survey of the history surrounding adoption of the Sherman Act, "Not once did a congressman condemn a restraint imposed by financially disinterested actors," such as state or local regulators.[59]

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[57] *See* 21 Cong. Rec. 2460 (1890) (remarks of Sen. Sherman) ("I admit that it is difficult to define in legal language the precise line between lawful and unlawful combinations. This must be left for the courts to determine in each particular case."); *id.* at 4099 (Rep. Bland); *id.* at 4089 (Rep. Culberson); *id.* at 3148 (Sen. Edmunds); *id.* at 2558 (Sen. Turpie).

[58] 21 Cong. Rec. 2728 (1890).

[59] Elhauge, *supra* note 12, at 700.

Second, in application, a substantive preemption approach focused on the costs of state and local regulation answers none of the difficult questions courts confront today in state action immunity cases. Put simply, it does not provide a workable set of standards for courts to decide modern state action exception issues, especially those of the type that that the FTC has recently identified as being of concern.[60] At core, as recent state action exception cases illustrate, issues of delegation within state governments are as significant to judicial decisions to extend antitrust exceptions as pure assessment of the substantive purposes of antitrust law or economic efficiency. In deciding to extend state action immunity, modern courts focus not only on substantive preemption principles, but also pay attention to the procedures under which a state regulator makes its decision. The delegation inquiry in state action exception cases provides an especially useful set of tools for courts in addressing problems of extending antitrust laws to private conduct that is sanctioned through regulatory inaction in industries undergoing change.

Indeed, a purely substantive preemption approach must confront how state regulators still may be entitled to deference notwithstanding ambiguity under the Sherman Act. The Supreme Court's longstanding presumption against preemption – an interpretive canon that reflects a desire to protect state regulatory processes and state and local sovereignty – advises strongly against allowing state regulation to ever take priority over the Sherman Act.[61] As a general matter, the Court requires a "clear statement" or other strong evidence of a "clear and manifest purpose of Congress" before finding a

[60] *See* FTC STATE ACTION REPORT, *supra* note 4, at 34-36 (discussing the problem of broad regulatory regimes).
[61] Rice v. Santa Fe Elevator Corp., 331 U.S. 218 (1947).

state law is preempted.[62] If such a presumption were to apply explicitly in the context of antitrust law, the judicial decision reflected in state action antitrust doctrine would hinge on federal, not state, regulation.

Squire's response to this concern in defending a preemption-based understanding of state action is to read the Sherman Act broadly as national public interest legislation that ought to generally preempt narrowly crafted state and local laws[63] – an approach that is generally consistent with others who take the Chicago School approach of reading the pro-competition policies of legislative ambiguity in the Sherman Act broadly while reading other kinds of legislation narrowly as interest-group legislation.[64] This approach to statutory interpretation has some elegance and is particularly appealing to market-oriented advocates of the Sherman Act. It also does take into account some process-based concerns in addressing the tension between state regulation and national competition laws. But its fault is in giving state and local government short shrift as legitimate political bodies. Even if it is acknowledged, as I believe it should be, that state and local decisions are more susceptible to interest group influence than federal

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[62] *Id.* at 230. *See also* Metronic v. Lohr, 519 U.S. 470, 485 (1996) ("[T]he purpose of Congress is the ultimate touchstone in every pre-emption case."); Solid Waste Assocs. Of N. Cook County v. U.S. County of Engineers, 531 U.S. 159, 172-73 (2001) (seeking congressional "clear statement" that agency was authorized to "invoke the outer limits" of congressional authority and commenting that "[t]his concern [about agency authority] is heightened where the administrative interpretation alters the federal-state framework by permitting federal encroachment on a traditional state power.").

[63] *See* Squire, *supra* note 10, at 107.

[64] *See generally* Herbert Hovenkamp, *Antitrust Policy After Chicago*, 84 MICH. L. REV. 213, 252-53 (1984). This Chicago School approach, of course, borrows from a synthesis of Federalist No. 10 – in which James Madison famously cautioned about the interest group dynamics of lawmaking at the state and local level -- and the statutory interpretation insights of modern public choice theory – which favor broad interpretation of public interest statutes and narrow interpretation of interest group legislation. *See* JERRY MASHAW, GREED, CHAOS AND GOVERNANCE (Yale U. Press 1996).

lawmaking, it does not follow that federal courts should condemn all state and local process and presumptively favor an ambiguous national statute over them. A process-based approach to state action immunity has much more to lend to the analysis of whether state or local regulations give rise to an antitrust exception. Specifically, it recognize that what happens within a state or local governmental unit – how regulator decisions are made and by whom − is significant to the decision to suspend application of the Sherman Act.

In addition, it bears noting that, as a practical matter, courts applying the state action exception have failed to interpret state laws and local laws consistent with the Chicago School approach Squire urges. Instead, against the implicit backdrop of the well-acknowledged presumption against preemption, courts have largely deferred to state and local regulators. The siren song of vertical deference has had an overwhelming appeal to federal courts, even where it is clear that there is mischief in the works at the state and local level. As a result, courts have extended the state action exception to many scenarios where it is not warranted, even under a substantive preemption approach based on the cost considerations that Squire emphasizes.

For example, state and local regulators do not always adopt explicit and public regulatory programs with well-defined procedures, such as marketing referenda with enforcement mechanisms or cost-of-service hearings. Instead, state and local regulators are increasingly drawing on different kinds of regulatory approaches – sometimes designed to restrict competition and sometimes designed to further it. Some states have banned competition within the state in industries such as electric power, in which interstate competition is authorized (and perhaps even encouraged) by federal law. Some

states have approved restraints between competitors that, unlike, the California raisin producer marketing program, are not voluntary and which do not contain clear enforcement mechanisms. Some states have abolished cost-of-service hearings in favor of so called "market-based rates," designed to further market-oriented goals. In addition, states have increasingly looked to regulatory disclosure and enforcement regimes, which require firms to provide information to regulators but leave agencies significant discretion in deciding what to do with such information.[65] Unlike some of the previous instances in which courts have expressed comfort with state regulation, such as state regulatory ratemaking proceedings, these new approaches challenge courts to seriously evaluate the effectiveness of state regulatory oversight. To date, courts simply have not risen to the challenge presented by new approaches to regulation at the state and local level.

B. The State Action Exception and Regulatory Inaction in Industries Undergoing Change

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[65] In deregulated telecommunications markets, for example, it has been observed that the regulatory model has shifted from firm-specific cost-of-service hearings towards regulating industry structure through firm-specific tariffs and through ex ante rules for defining network access. *See* Christopher S. Yoo, *New Models of Regulation and Interagency Governance*, 2003 M.S.U. L. REV. 701, 707 (2003) (noting that "policymakers have increasingly moved away from tariffs towards more flexible agreements negotiated on a customer-by-customer basis" and that regulators have increasingly begun to abandon classic rate regulation in favor of a new approach known as "access regulation"). *See also* Joseph D. Kearney & Thomas W. Merrill, *The Great Transformation of Regulated Industries Law*, 98 COLUM. L. REV. 1323, 1340-57, 1364-83 (1998) (describing broader trends towards detariffing and access regulation across all regulated industries); Daniel F. Spulber & Christopher S. Yoo, *Access to Networks: Economic and Constitutional Connections*, 88 CORNELL L. REV. 885, 889-90, 960- 70, 980-87, 1002-18 (2003) (describing access regulation in local telephony).

[65] Courts do so by making a determination that the allegedly anticompetitive conduct was either explicitly envisioned by, or foreseeable to, state legislators. *See supra* notes 42-45 (referencing the foreseeability approach).

Recent cases involving the antitrust state action exception, particularly in the deregulated electric power industry, illustrate the problem with the current judicial approach. Since the state action exception serves a filter function for antitrust enforcement, as a routine defense in antitrust cases it increasingly plays an important role as formerly regulated firms are deregulated.[66] Yet, according to most appellate courts, antitrust law's enforcement gates remain closed, allowing the conduct of many private firms to escape antitrust scrutiny altogether in emerging competitive markets. Despite *Ticor's* signal that active supervision is alive and well as a judicial basis for evaluation, lower courts – especially the Eighth, Tenth and Eleventh Circuits − generally have continued to take a deferential approach to state action antitrust doctrine in reviewing state regulation in deregulated markets. Even where what is at issue is state, not local, regulation and even where competitive markets for service are emerging, these courts are not inclined to allow the Sherman Act to apply to private conduct in formerly regulated industries where there is some state regulatory scheme, however incomplete it is.

Illustrative of this deferential approach to judicial intervention, the Tenth Circuit has embraced particularly broad antitrust immunity for electric utilities, despite the introduction of competition to large segments of the industry. For example, the Tenth Circuit extended a state action antitrust exemption to Oklahoma Gas and Electric Company's (OG&E) conduct based on evidence that the state regulatory agency had "general supervision" authority over the utility, "including the power to fix all of OG&E's rates for electricity and to promulgate all the rules and regulations that affect

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[66] *See* Darren Bush, *Mission Creep: Antitrust Exemptions and Immunities as Applied to Regulated Industries* 2006 UTAH L. REV. 613; Jeffrey D. Schwartz, *The Use of Antitrust State Action Doctrine in the Deregulated Electric Utility Industry* 48 AM. U. L. REV. 1449 (1999).

OG&E's services, operation, and management."[67] The Tenth Circuit deemed a state agency's power to engage in rate review as itself sufficient for applying a state action antitrust exemption, effectively rendering the active-supervision requirement meaningless. While the court cited a previous case which "found that the use of similar authority over an electric utility satisfied the active supervision requirement"[68] as a basis for this conclusion, it made no effort whatsoever to discern evidence of the affirmative use of such authority by the regulator with respect to the utility whose conduct was at issue.[69] Moreover, based on a review of the docket index for both the appellate and trial courts, there is no indication that the Oklahoma regulatory agency made a single filing in the trial or appellate case; it did not weigh in as amicus in the appeal to the Tenth Circuit, although Edison Electric Institute (EEI) (a nationwide industry association representing private utilities such as OG&E) filed an amicus brief.[70]

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[67] Trigen-Oklahoma City Energy Corp. v. Okla. Gas & Elec. Co., 244 F.3d 1220, 1226 (10th Cir. 2001).

[68] *Id*. (citing Lease Light, Inc. v. Public Service Co. of Okla., 849 F.2d 1330, 1333 (10th Cir. 1988)).

[69] The case presents a notable contrast to a later Tenth Circuit case, in which the court refused to extend a state action exception to unilateral activity which was "not mandated, nor authorized, nor reviewed, nor even known about" by the state regulator. Telecor Communications, Inc. v. Southwestern Bell Telephone Co., 305 F.3d 1124, 1140 (10th Cir. 2002). This case is also too narrow in defining the limits of state action antitrust doctrine. As is discussed *infra*, refusal to extend the state action exception should not be limited to purely "unilateral" activity, but should also extend to bilateral activity in which the regulator plays a passive role.

[70] This observation is based on a review of the docket indices available through Westlaw for both the appellate and trial court cases. *See* 244 F.3d 1220, 1226 (10th Cir. 2001) (Westlaw hyperlink to "Briefs and Other Related Doctrines); 1999 WL 136900 (Westlaw hyperlink to "Briefs, Pleadings and Filings").

The Eighth Circuit has taken a similarly deferential approach to the state action antitrust defense.[71] North Star Steel, a customer located within the exclusive service territory of MidAmerican, an electric utility in Iowa, sought to purchase competitively priced electricity and requested that MidAmerican wheel power to it.[72] MidAmerican refused, and North Star sued, alleging that the utility violated the antitrust laws by refusing to allow access to its transmission lines.[73] The court found that active supervision of the utility's conduct existed due to the fact that by Iowa statute new customers were assigned to exclusive service providers and, in the event there was a conflict over which provider was in control of a given area, the regulator determined which provider should "occupy" the area.[74] The court found that Iowa's legislature "affirmatively expressed" a policy of displacing competition in the market for retail electric service.[75] The court refused, however, to explore the substantive basis for the agency's regulatory determinations in defining exclusive service territories. For instance, even though the state had experimented with limited "pilot" retail wheeling programs,[76] the court did not evaluate how the state agency's efforts to promote competition in power supply could coexist with maintaining exclusive service territories over transmission and distribution, effectively deferring to state regulators on all of these issues. In fact, the only regulatory action that was discussed by the court related to the

[71] North Star Steel Co. v. MidAmerican Energy Holdings Co., 184 F.3d 732 (8th Cir. 1999).
[72] *Id*. at 734.
[73] *Id*.
[74] *Id*. at 734-35.
[75] Given a previous ruling by the Iowa Supreme Court, the Eighth Circuit assumed for collateral estoppel purposes that "under Iowa law the exclusive service territory provisions include the generation of electricity for retail sales." *Id*. at 732.
[76] *Id*. at 736.

definition of distribution service territories, not the allocation of power supply or generation. The court also reasoned that "less pervasive regulatory regimes have been held to satisfy the active supervision prong."[77] In this appeal, the Iowa Utilities Board filed an amicus brief before the Eighth Circuit discussing its regulatory approach,[78] but the court did not address explicitly the issue of how much deference it should afford to the state regulator's position.

One of these "less pervasive" regulatory regimes is blanket state prohibitions – by statute or regulation − of certain types of pro-competitive conduct. For example, according to Florida's regulators and courts, Florida has adopted a statutory prohibition on retail electric competition, outside of self-wheeling arrangements. Although Florida certainly does not have a clear legislative statement regarding the issue, Florida's Public Service Commission (PSC) had adopted a regulation which prohibits retail wheeling to provide access to competitive power supply outside of "self-wheeling" arrangements (e.g., a supplier transmitting power over the utility's lines for the supplier's own use). A Florida Supreme Court case had previously interpreted this regulation to preclude cogenerators from selling their power in the retail market.[79] Accepting both the regulation and the Florida Supreme Court's characterization of the regulation, the Eleventh Circuit applied the state action exemption to preclude an antitrust action by a cogeneration facility against a utility which refused to wheel power at a competitive

[77] *Id*. at 739.
[78] This observation is based on a review of the docket index available through Westlaw for the appellate case. *See id.* (Westlaw hyperlink to "Briefs and Other Related Doctrines).
[79] PW Ventures, Inc. v. Nichols, 533 So.2d 281 (Fla. 1988)

rate.[80] The court reasoned that "the doors to the PSC were open to all with standing to complain,"[81] but nowhere did the court identify how a private cogenerator might raise such issues before the Florida PSC. Arguably, it could not, other than by directly challenging the state agency regulation authorizing the allegedly anticompetitive conduct. The Florida PSC filed an amicus brief with the Eleventh Circuit, and the Eleventh Circuit agreed with the state regulator's interpretation of Florida law,[82] without discussing the issue of how much deference should be afforded the agency's interpretation in its brief.

A way of understanding the antitrust claim before the Eleventh Circuit was as a collateral attack on the state agency rule based on a substantive violation of federal antitrust law. The decision echoes a previous Eleventh Circuit case, in which it was found that the state action defense protects a regulated electric utility's division of service territories in the county in which a customer is located from Sherman Act restraint of trade claims.[83] Taken together, these Eleventh Circuit opinions seem to suggest that the mere existence of an agency rule authorizing anticompetitive conduct is enough to trigger active supervision.[84] If this holds, however, not only the actions of a state legislature can

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[80] TEC Congeneration, Inc. v. Florida Power & Light Co., 76 F.3d 1560 (11th Cir. 1996).
[81] *Id*. at 1570.
[82] This observation is based on a review of the docket index available through Westlaw for the appellate case. *See id.* (Westlaw hyperlink to "Briefs and Other Related Doctrines).
[83] Praxair, Inc. v. Florida Power & Light Co., 64 F.3d 609 (11th Cir. 1995).
[84] *Id*. at 613 ("An agency's interpretation of its own regulations must be given controlling weight unless that interpretation is plainly erroneous or inconsistent with regulation."). In an earlier case, the Eleventh Circuit relied entirely on the clear-articulation requirement to find a state action exception. *See* Municipal Utilities Board of Albertville v. Alabama Power Co., 934 F.2d 1493 (11th Cir. 1991). This seems to completely take the state action antitrust exception outside of the two part *Midcal* test, turning it into a one-step clear-articulation requirement. In *Southern Motors Carriers Rate Conference, Inc. v. U.S*., 471 U.S. 48, 61-62 (1985), the Court stated:

insulate private conduct from antitrust liability; a unilaterally adopted agency rule can also excuse private conduct from antitrust enforcement, even if this rule prohibits pro-competitive conduct with little or no agency oversight.

This deferential approach to antitrust enforcement filtering by state regulatory agencies has serious implications for the enforcement of the antitrust laws in deregulated markets. In California's deregulated electric power market, wholesale power suppliers possessing market power have been alleged to have engaged in tacit collusion to withhold supply and to thus artificially inflate their prices.[85] Of course, both federal and state regulation continued, even in the context of California's failed regulation plan. The Federal Energy Regulatory Commission (FERC) made its own determinations that individual firms lacked market power and had approved several market-based tariffs, allowing deregulation in the wholesale market. As to California's retail market, state agencies as well had approved the sale of power by these suppliers through the state-sanctioned market exchange.[86] To the extent that the behavior of any private firms operating in this market raised a plausible Section one (or even a Section two) antitrust

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> The federal antitrust laws do not forbid the States to adopt policies that permit, but do not compel, anticompetitive conduct by *regulated* private parties. As long as the State clearly articulates its intent to adopt a permissive policy, the first prong of the *Midcal* test is satisfied.

However, in the same opinion, the Court made it clear that the presence or absence of compulsion is not the "*sine qua non* to state action immunity." *Id*. at 60.

[85] *See* Darren Bush & Carrie Mayne, *In (Reluctant) Defense of Enron: Why Bad Regulation is to Blame for California's Power Woes (Or Why Antitrust Law Fails to Protect Against Market Power When the Market Rules Encourage Its Use)*, 83 OR. L. REV. 207 (2004); Robert B. Martin, III, *Sherman Shorts Out: The Dimming of Antitrust Enforcement in the California Electricity Crisis*, 55 HAST. L.J. 271 (2003).

[86] For discussion of this regulatory framework, see Jim Rossi, *The Electric Power Deregulation Fiasco: Looking to Regulatory Federalism to Promote a Balance Between Markets and the Provision of Public Goods*, 100 MICH. L. REV. 1768 (2002).

claim under the Sherman Act, the mere existence of a state sanctioned and supervised market should not give rise to a state action exception.

Judicial decisions that adopt this deferential approach send mixed signals and present a barrier to plaintiffs seeking to sue under the antitrust laws. Still worse, these decisions invite private manipulation of state and local regulators to create antitrust immunity. Particularly as state and local governments engage in lawmaking in partially deregulated markets, and move away from the standard regulatory process afforded in a public rate hearing, the risks of private manipulation of the policymaking process are heightened.[87] Given this, courts could improve the functioning of deregulated markets, as well as the political process, if they could devise a more principled way of exercising their filter function in the state action exception context. Since *Hallie*, the Supreme Court has abandoned the political process informed municipal-state distinction in assessing state action antitrust doctrine. In place of this, federal courts embrace a highly deferential stance in reviewing both state and local regulation as they apply the state action exception to antitrust challenges to allegedly anticompetitive conduct. If a state regulates an activity, courts reviewing private conduct under complex regulatory schemes are increasingly likely to imply a regulatory policy − sometimes even absent a clear articulation of regulatory purpose by the state.[88] Especially given the strong background judicial preference for a presumption against preemption, the general approach strongly disfavors judicial intervention in applying the state action exception as an antitrust defense.

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[87] *See supra* note 64.

[88] Courts do so by making a determination that the allegedly anticompetitive conduct was either explicitly envisioned by, or foreseeable to, state legislators. *See supra* notes 42-45 and accompanying text (referencing the foreseeability approach).

Many courts also imply the active-supervision prong of state action antitrust doctrine, limiting judicial intervention in many recent cases involving deregulated electric power markets, especially in the Eighth, Tenth and Eleventh circuits. These courts consistently have failed to evaluate the degree of scrutiny provided by state or local regulators, as well as whether the purpose of this supervision overlaps with the pro-competitive goals of the Sherman Act. Their approach evinces a serious lapse of the judicial filtering function in the consideration of antitrust challenges to private conduct in restructured industries, such as electric power and telecommunications. Without a judicial safeguard, overbroad judicial endorsement of the state action exception allows allegedly anticompetitive private conduct to escape scrutiny altogether and risks undermining the goals of competition law, particularly as national markets in these industries develop. In recognition of this serious problem, Easterbrook[89] and Squire,[90] along with many other scholars, including John Shepard Wiley, [91] Matthew Spitzer,[92] and

[89] *See supra* note 9.
[90] *See supra* note 10.
[91] Responding to *Hallie*, John Shepard Wiley proposes that courts directly address the efficiency, and in particular public choice, implications of state and local legislation in deciding whether to accept an antitrust state action defense. John Shepard Wiley, Jr., *A Capture Theory of Antitrust Federalism*, 99 HARV. L. REV. 713. (1986). According to Wiley, if anticompetitive legislation is inefficient and the result of producer-interest lobbying, the state action defense should not shield conduct authorized under the legislation from scrutiny under the Sherman Act. *Id*. at 788-89.
[92] Matthew Spitzer argues that federal courts should intervene in evaluating antitrust claims notwithstanding state or local legislation, if the legislation is inefficient or transfers wealth from consumers to producers. Matthew Spitzer, *Antitrust, Federalism, and the Rational Choice Political Economy: A Critique of Capture Theory*, 61 S. CAL. L. REV. 1293 (1988).

others,[93] have advanced approaches that focus on the substantive efficiency of state and local regulation with a particular eye towards limiting capture in the political process.

In contrast, Merrick Garland, now a judge of the U.S. Court of Appeals for the District of Columbia, has been one of the most strident proponents of a strongly deferential approach to the state action exception in considering the relevance of state regulation.[94] In a leading article, he argues that there is no principled basis for distinguishing between municipalities and states for federal antitrust law purposes.[95] Put simply, his view is that state and local legislation should not be assessed by the federal courts for either their efficiency or rent-seeking effects, or for process-based concerns, in antitrust cases.[96] Defenders of judicial deference in antitrust federalism see judicial review of state and local laws for efficiency, rent-seeking or public interest goals as tantamount to federal courts returning to substantive due process review of state and local regulation, encroaching on decentralized lawmaking in the economic regulation context. Like advocates of deregulatory takings in public utility law attempt to reinvigorate *Lochner*[97] in determining government liability for regulatory transitions,[98] strong

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[93] Cirace, *supra* note 34, at 515 (arguing that courts should employ an efficiency test to evaluate the effects of state and local legislation on claims under the Sherman Act); Steven Semeraro, *Demystifying Antitrust State Action Doctrine*, 34 HARV. J. L. & PUB. POL'Y 203, 212 (2000) (arguing that, based on a "status choice" approach, courts should inquire "whether a government actor's conception of the public interest is being furthered by an anticompetitive restraint.").

[94] *See* Merrick B. Garland, *Antitrust and State Action: Economic Efficiency and the Political Process*, 96 YALE L.J. 486 (1987).

[95] *Id*. at 502-07.

[96] *Id*. at 519.

[97] Lochner v. New York, 198 U.S. 45 (1905).

[98] *See* J. GREGORY SIDAK & DANIEL F. SPULBER, DEREGULATORY TAKINGS AND THE REGULATORY CONTRACT: THE COMPETITIVE TRANSFORMATION OF NETWORK INDUSTRIES IN THE UNITED STATES (1997). For criticism, see Susan Rose-Ackerman & Jim Rossi, *Disentangling Deregulatory Takings,* 86 VA. L. REV. 1435 (2000); Jim Chen, *The*

deference advocates are concerned judicial intervention in the context of evaluation of the state action defense necessarily will lead courts to a *Lochner*-type review of regulation.[99] Garland, for example, favors exempting from judicial review under the Sherman Act all regulatory actions by state and local governments except for delegations of the power to restrain the market to private parties.[100]

Yet, while it has been a hundred years since *Lochner* was decided, and more than sixty years since it reigned supreme in utility law,[101] no one – including those who wish to evaluate the efficiency of state regulations in the state action antitrust exception context − seriously wishes to invoke its ghost.[102] Indeed, if judicial review of decentralized lawmaking is approached in a principled and cautious manner, a strongly deferential stance to state regulators is not necessary to limit the scope of judicial review. As Daniel Gifford has argued, federal courts have the capacity to review state and local legislation without directly addressing their substantive efficiency effects.[103] Gifford suggests that courts apply the same "free market" approach to the state action antitrust exception that they apply under the dormant commerce clause by recognizing two markets. State action antitrust evaluation would protect the internal (intra-state) market

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Second Coming of Smyth v. Ames*,* 77 TEX. L. REV. 1535 (1999); Herbert Hovenkamp, *The Takings Clause and Improvident Regulatory Bargains,* 108 YALE L.J. 801 (1999); Jim Rossi, *The Irony of Deregulatory Takings,* 77 TEX. L. REV. 297 (1998).

[99] Garland, *supra* note 94, at 488 (making an explicit comparison to *Lochner*).

[100] *Id*. at 506.

[101] *See* Federal Power Comm'n v. Hope Natural Gas Co., 320 U.S. 591 (1944) (abandoning substantive review of utility rates).

[102] Chen, *supra* note 98, at 1568.

[103] Gifford, *supra* note 11.

from trade restraints, while the dormant commerce clause extends to the external (inter-state) market.[104]

Robert Inman and Daniel Rubinfeld have perhaps made the most strident political process based argument in the antitrust federalism context, arguing that the state action antitrust defense should only apply where regulation imposes substantial spillover costs on out-of-state interests.[105] On their view, the state action exception would not remove from antitrust enforcement all private monopolies sanctioned by regulation, but only those which are actively supervised by the state for purposes of limiting the harms that flow from unregulated monopoly. As such, the active-supervision prong of state action antitrust doctrine is not inherently anti-commerce, but recognizes the necessity for regulation to correct for certain market failures where the public interest demands it. On this understanding, for state action antitrust doctrine to make sense in application, enforcement of pro-commerce norms is necessary where the federalism-based value of participation conflicts with efficiency, as may occur if state regulation creates spillover costs for those who do not participate in the relevant state or local regulatory process.[106]

In contrast to even this modest process-based view of judicial intervention, recent cases involving utility restructuring illustrate the problem presented by the low state action exemption threshold many lower courts currently utilize. While Squire's federal preemption approach embraces skepticism in approaching state and local laws, in practice a federal preemption approach to state action antitrust doctrine may further encourage a more deferential approach given the well-recognized judicial presumption against

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[104] *Id*.
[105] Inman & Rubinfeld, *supra* note 27.
[106] *Id.*

preemption. Further, the substantive cost criteria for evaluating federal preemption fail to adequately address state laws that do not take an affirmative regulatory approach. Especially in a process of restructuring or deregulation – which gives birth to the norms of competition – private firms face strong incentives to use the regulatory process to enact partial regulatory schemes for purposes of establishing immunity from the antitrust laws. As states have begun to deregulate industries such as telecommunications and electric power, the nature of state regulation has changed. Rather than regulating utilities through rate and traditional certificate-of-need proceedings, increasingly regulators are laying down general structural rules or approving structural, rather than pricing, tariffs. Most agree that, with the rise of competitive markets, antitrust law plays a more – not less – important role than under traditional rate regulation.[107] As one Department of Justice lawyer has recognized in the context of antitrust enforcement in emerging competitive electric power markets, "If a state opens its retail market to competition, then the state

[107] *See* Merrill, *supra* note 65; Spulber & Yoo, *supra* note 65; Dibadj, *supra* note 11. *See also* Ray S. Bolze et al., *Antitrust Law Regulation: A New Focus for a Competitive Energy Industry*, 21 ENERGY L.J. 79 (2000); Craig A. Glazer & M. Bryan Little, *The Roles of Antitrust Law and Regulatory Oversight in the Restructured Electricity Industry*, 12 ELECTRICITY J. 21 (May, 1999); William J. Kolasky, *Network Effects: A Contrarian View*, 7 GEO. MASON L. REV. 577 (1999); William Baer, *FTC Perspectives on Competition Policy and Enforcement Initiatives in Electric Power before the Conference on the New Rules of the Game for Electric Power: Antitrust and Anticompetitive Behavior* (December 4, 1997); John Burritt McArthur, *Antitrust in the New [De]Regulated Natural Gas Industry*, 18 ENERGY L.J. 1 (1997); Thomas A. Piraino, Jr., *A Proposed Antitrust Analysis of Telecommunications Joint Ventures*, 1997 WIS. L. REV. 639; Robert Pitofsky, *Remarks: Competition Policy in Communications Industries: New Antitrust Approaches,* before the Glasser Legal Works Seminar on Competitive Policy in Communications Industries: New Antitrust Approaches (March 10, 1997), *available at* http://www.ftc.gov/speeches/pitl.htm; Jade Alice Eaton, *Recent United States Department of Justice Actions in the Electric Utility Industry* 9 CONN. J. OF INT'L L. 857 (1994).

action doctrine would not apply to conduct that related directly to retail competition."[108] The reality of separating regulated from unregulated conduct for antitrust federalism purposes is hardly simple, however, as states frequently endorse competition in some, but not all, aspects of formerly regulated industries such as electric power and telecommunications.

It is entirely sound for a court to extend a state action antitrust defense where a state or locality has a history of affirmative active state regulation, such as regular hearings to set rates based on cost, and continues to embrace this regulatory approach. However, courts also extend state action exception to antitrust enforcement in contexts where a state official has the jurisdiction to regulate but fails to exercise it – even where there is little or no history of regulatory action. Courts are also asked to review not only traditional agency decisions, such as cost-of-service ratemaking, but also are asked to evaluate the state action implications of agency inaction, such as a failure to revoke a permit or a failure to enforce regulations. In such contexts jurisdiction, or vague reference to a past history of regulation, is of little or no relevance to how state regulators approach the problem today. Regulatory rationales – including the relationship between regulation and competition – can be proffered by private antitrust defendants or regulators on appeal, rather than at the time the agency adopts a specific regulatory approach. To the extent state regulators provide any rationale at all (and in many instance they do not make any filings at all in antitrust litigation), the rationalization for failing to regulate is only provided by state officials ex post, in briefs filed in antitrust

[108] Joseph F. Schuler, *State Action Doctrine Losing Relevance, Department of Justice Attorney Says*, PUBLIC UTILITIES FORTNIGHTLY, May 15, 1999, at 70 (quoting Milton A. Marquis, attorney with U.S. Department of Justice, Antitrust Division).

case. When a state regulator does file an amicus brief, courts do not address the level of deference they ought to afford the agency's position.

At one extreme, the presumption against preemption results in too much deference to state regulators. At the other extreme, the federal preemption approach, coupled with the Chicago-school skepticism of state and local regulation, results in too little deference. What both approaches share is that they treat all state and local regulators homogenously, without regard to institutional and other variables that influence the accountability of regulation at the state and local level.[109] As I will argue below, in such circumstances state action antitrust exemption cases could learn from a delegation approach and *Chevron* step two's focus on reasons, rather than antitrust law's historical emphasis on clear statements, jurisdictional delegation, and agency actions in evaluating state action defenses. Giving reasons would allow federal courts to evaluate whether officials have legitimate goals in mind in refusing to regulate, or whether they are merely opting out of antitrust enforcement to favor powerful interest groups at the state and local level. In addition, such an approach could force state officials to provide reasons before making a decision not to regulate conduct, subjecting such reasons to review within a state's regulatory system.

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[109] Squire does emphasize that, ultimately, process matters in some way to the assessment of state regulation, but his test for assessing the sufficiency of process is limited to assessing whether the decisionmaker gives independent weight to interests of both sides to a transaction. Squire, *supra* note 10, at 117. Hence, a one-side ratemaking proceeding, whether before a legislature or a regulatory agency, would be problematic under his view, but he is willing to allow regulators to "enrich producers by raising prices, as long as consumer interests enjoy independent weight in the price-selection method." *Id.* This helps to sustain the preemption approach's promise of being "deferential . . . but not toothless." *Id.* at 107. But such an approach relegates process a mere evidentiary role in assessing whether the Sherman Act preempts state or local regulation.

II. *CHEVRON*, DELEGATION, AND REASONABLENESS REVIEW

The *Chevron*[110] case, often seen as a very pro-agency approach to the judicial view of regulation, has attracted the attention of administrative law scholars since it was decided in 1984. *Chevron* stands at the center of many major recent decisions by the U.S. Supreme Court.[111] With the *Mead* case, decided in 2001, the Supreme Court signaled a clear retreat away from application of the *Chevron* test as the exclusive model for reviewing agency interpretations of law.[112] However, *Chevron* remains the predominant controlling framework for most courts and commentators approaching judicial review of agency legal interpretations, as well as agency policy decisions made in the context of broad legislative delegations.[113] The rationale of *Chevron* deference and many aspects of its application involving delegation concerns strongly parallel the kinds of issues courts

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[110] 467 U.S. 837 (1984).

[111] Gonzalez v. Oregon, 126 S.Ct. 904 (2006); National Cable & Telecommunications Association v. Brand X Internet Services, 545 U.S. 967 (2005); Barnhart v. Walton, 535 U.S. 212 (2002); United States v. Mead Corp., 533 U.S. 218 (2002); Whitman v. American Trucking Assns., Inc., 531 U.S. 457, 468 (2001); Food and Drug Administration v. Brown & Williamson Tobacco Corp., 529 U.S. 120 (2000); Christensen v. Harris County, 529 U.S. 576 (2000).

[112] In *Mead*, the Court suggested that *Skidmore* rather than *Chevron* will provide the appropriate standard for reviewing courts in approaching many agency legal interpretations. 533 U.S. at 230.

[113] *See* Cass R. Sunstein, Chevron *Step Zero*, 92 VA. L. REV. 187, 191 (2006) (describing the significance of Step Zero, "the initial inquiry into whether the *Chevron* framework applies at all," but retaining *Chevron* as the overarching framework); Lisa Schultz Bressman, *How* Mead *Has Muddled Judicial Review of Agency Action*, 58 VAND. L. REV. 1443, 1446 (2005) (criticizing lower courts approach to applying *Mead* as a kind of "*Chevron* avoidance"); Thomas W. Merrill, *The* Mead *Doctrine: Rules and Standards, Meta-Rules and Meta-Standards*, 54 ADMIN. L. REV. 807 (2002) (observing that *Chevron* continues to apply after *Mead* as a meta-rule or meta-standard governing the scope of deference). *See also* Thomas W. Merrill & Kristin E. Hickman, Chevron's *Domain*, 89 GEO. L.J. 833, 833 (2001) (noting that *Chevron* "dramatically expanded the circumstances in which courts must defer to agency interpretations of statutes.").

confront when they address antitrust immunities and defenses, such as the state action exception.

A. The Rise of the *Chevron* Framework

Justice Stevens' unanimous *Chevron* opinion articulates what has become the predominant judicial paradigm for review of agency interpretations of statutes and regulations. In *Chevron*, the Supreme Court upheld the Environmental Protection Agency's (EPA's) reasonable interpretation of the term "stationary sources" in the Clean Air Act Amendments of 1977.[114] The statute required "new or modified major stationary sources" of air pollution to comply with certain permit requirements and authorized the EPA to define the relevant terms by regulation.[115] Initially, the EPA determined that the "stationary source" referred to each individual piece of equipment that emitted pollution, but in 1981 the agency changed its position by construing "stationary source" more expansively, to mean an entire plant. As an effect of this new interpretation, firms could avoid some pollution permit requirements by offsetting the pollution from new equipment by reducing emissions from old equipment in the same plant.[116]

The *Chevron* Court's approach to reviewing an agency's statutory interpretation distills the judicial review task into two distinct questions. At step one of *Chevron*, the Court inquires into whether Congress "has directly spoken to the precise question at issue."[117] If Congress has – and has done so clearly – the court "must give effect to the

[114] Pub. L. No. 9595, 91 Stat. 685 (1977).
[115] 467 U.S. at 840 n.1 (quoting 42 U.S.C. § 7502(b)(6)).
[116] *See* 467 U.S. at 858-59.
[117] *Id*. at 842.

unambiguously expressed intent of Congress."[118] If, however, the statute at issue is silent or ambiguous with respect to the specific question, a court is to move on to *Chevron*'s step two. At step two, a court's inquiry is limited to determining whether the agency's legal interpretation "is based on a permissible construction of the statute."[119] At step two, *Chevron* endorses judicial deference to the agency's statutory interpretation. By leaving a gap in its statutory language for the agency to fill, Congress has made "an express delegation of authority to the agency to elucidate a specific provision of the statute by regulation."[120] The gap, the Court observed, may be explicit or implicit.[121] The role of a court in such instances is to defer to the agency's statutory interpretation, giving the agency's regulations "controlling weight unless they are arbitrary, capricious, or manifestly contrary to the statute."[122]

Justice Marshall's exhortation in *Marbury v. Madison* that it is "the province and duty of the judicial department to say what the law is"[123] thus takes a back seat to an inquiry into the reasonableness of the agency's legal interpretation at step two of *Chevron*. In this sense, one might see *Chevron* as having a basis in separation of powers.[124] Surely, however, the power to define the balance of powers in judicial review

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[118] *Id*. at 843.
[119] *Id*.
[120] *Id*. at 843-44.
[121] *See id*. at 865.
[122] *Id*. at 844.
[123] 5 U.S. (1 Cranch) 137, 177 (1803).
[124] Cynthia R. Farina, *Statutory Interpretation and the Balance of Power in the Administrative State*, 89 COLUM. L. REV. 452, 476 (1989) ("It is surely a far more remarkable step than *Chevron* acknowledged to number among Congress's constitutional prerogatives the power to compel courts to accept and enforce another entity's view of legal meaning whenever the law is ambiguous.").

remains within Congress's prerogative, as is illustrated by the many statutes in which Congress has defined standards of review or even abolished judicial review altogether.

Rather than separation of powers, *Chevron* is best explained by reference to a more pragmatic set of institutional concerns aimed at improving the quality of agency decisions and the accountability of the process that produces them. An appreciation of agency expertise, the limits of the specialized knowledge of judges, and political accountability are at the normative core of Justice Stevens' rationale for deference to the agency in *Chevron*. "Judges are not experts in the field," Justice Stevens wrote in *Chevron*, and thus in interpreting statutory gaps courts should "rely upon the incumbent administration's views of wise policy to inform its judgments."[125] Justice Stevens emphasized that judicial deference to an agency's statutory interpretation furthers political accountability:

> the [EPA] Administrator's interpretation represents a reasonable accommodation of manifestly competing interests and is entitled to deference . . . Congress intended to accommodate both interests, but it did not do so itself on the level of specificity presented by these cases. Perhaps that body consciously desired the Administrator to strike the balance at this level, thinking that those with great expertise and charged with responsibility for administering the provision would be in a better position to do so; perhaps it simply did not consider the question at this level; and perhaps Congress was unable to forge a coalition on either side of the question, and those on each side decided to take their chances with the scheme devised by the agency.[126]

Implicit to Justice Stevens' accountability rationale is the recognition that agencies are institutionally superior to courts in their capacity for making accountable political

[125] 467 U.S. at 865.
[126] *Id*.

decisions against the backdrop of ambiguous statutory terms.[127] Agency legal interpretations will be subject to political oversight and thus are accountable to Presidential politics, as well as congressional oversight.[128] In addition, as Professor Peter Strauss has argued, for reasons of judicial economy *Chevron* promotes uniformity in regulatory policy. Because the Supreme Court has limited resources to resolve conflicting statutory interpretations by lower courts, judicial acceptance of agency legal interpretations of ambiguous statutory terms will promote uniformity in interpretation, providing regulated entities and other branches of government some degree of certainty in assessing the meaning of ambiguous statutory terms.[129] Thus, while some commentators see separation of powers[130] or Congressional intent to delegate lawmaking authority as the primary rationale for *Chevron* deference,[131] political accountability and

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[127] *See* Mark Seidenfeld, *A Syncopated* Chevron*: Emphasizing Reasoned Decisionmaking in Reviewing Agency Interpretations of Statutes*, 73 TEX. L. REV. 83 (1994).

[128] *See, e.g.*, Richard J. Pierce, Jr., *Political Control Versus Impermissible Bias in Agency Decisionmaking: Lessons from* Chevron *and* Mistretta, 57 U. CHI. L. REV. 481, 486 (1990) (explaining that *Chevron* is justified by the agency's superior political accountability). At the extreme, this view sees *Chevron* as working pure unitary executive principles.

[129] *See* Peter L. Strauss, *One Hundred Fifty Cases Per Year: Some Implications of the Supreme Court's Limited Resources for Judicial Review of Agency Action*, 87 COLUM. L. REV. 1093 (1987).

[130] *See, e.g.,* Farina, *supra* note 124, at 476 ("It is surely a far more remarkable step than Chevron acknowledged to number among Congress's constitutional prerogatives the power to compel courts to accept and enforce another entity's view of legal meaning whenever the law is ambiguous."). *See also* Michael Herz, *Deference Running Riot: Separating Interpretation and Lawmaking Under* Chevron, 6 ADMIN. L.J. 187, 189-90, 202-03 (1992) (using constitutional concerns of institutional roles of Congress to distinguish deference analysis for interpretive rules and legislative rules); Randolph J. May*, Tug of Democracy: Justices Pull for America's Separation of Powers*, LEGAL TIMES, July 9, 2001, at 51 (applauding *Mead* on the ground that its limits on *Chevron* are consistent with constitutional principles).

[131] *See* Merrill & Hickman, *supra* note 114 (arguing that Chevron doctrine should be defined with respect to Congress's intent to delegate lawmaking authority to an agency).

institutional concerns are also widely accepted as justifications for the doctrine.[132] Although it has been observed that the direct impact of *Chevron* on the doctrinal approach of lower courts is sometimes overstated,[133] studies suggest that the decision did affect the reversal and remand rates for judicial appeals of agency decisions in lower courts.[134]

B. Extending *Chevron* Review to State Economic Regulation

Apart from a very active current debate regarding the scope of *Chevron* deference, courts have struggled with two issues in applying *Chevron* to review of agency regulation. The purpose of this Article is not to catalog the entire range of problems that courts have confronted,[135] but to highlight the issues that are most relevant in expanding *Chevron*'s delegation structure to antitrust immunities and defenses. First, at step one of the *Chevron* inquiry courts have struggled with the role of non-textual information regarding statutory meaning. Although there is substantial disagreement regarding what sources courts should draw on in discerning statutory meaning, if taken seriously by

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[132] *See, e.g.,* David J. Barron & Elena Kagan, Chevron's *Nondelegation Doctrine*, 2001 S.CT. REV. 201, 223 (stating, "The only workable approach is the approach that *Chevron* took in the beginning: to fill in legislative silence about judicial review by making policy choices based on institutional attributes, with Congress then free to overrule these conclusions.").

[133] *See* Merrill, *supra* note 17 (*Judicial Deference to Executive Precedent*).

[134] Professors Peter Schuck and E. Donald Elliott observe that affirmance rates increased by almost 15% after *Chevron*, and both remands and reversals declined by roughly 40%. *See* Peter H. Schuck & E. Donald Elliott, *To the* Chevron *Station: An Empirical Study of Federal Administrative Law*, 1990 DUKE L.J. 984, 1058. The authors concluded, "On the evidence of this study, the Supreme Court is sometimes able to affect the shape of the court-agency relationship through the kinds of relatively broad, open-textured rule adopted in *Chevron*." *Id*. at 1059. Another study finds that the D.C. Circuit's deference to EPA interpretations increased after *Chevron*. *See* Aaron P. Avila, *Applications of the* Chevron *Doctrine in the D.C. Circuit*, 8 N.Y.U. ENVT'L L. J. 398 (2000).

[135] *See* Merrill & Hickman, *supra* note 114, at 848-52 (cataloging a range of "unresolved questions" with *Chevron's* application).

courts step one of *Chevron* creates incentives for clear legistative statements, thus enhancing the transparency of the legislative process. Second, while courts have struggled with the appropriate approach to *Chevron* step two, recent judicial and scholarly focus on the delegation issues presented at *Chevron* step two have a particular traction in the context of assessing state and local regulation.

1. Step One's Limits as a Clear Statement Rule

At step one of the *Chevron* inquiry, a court focuses primarily on what the statute means. Discerning meaning remains a controversial judicial task, but if a court can resolve the issue of judicial meaning, it is the judiciary prerogative to determine whether an agency's regulatory approach violates the statute. In cases such as *FDA v. Brown & Williamson,* in which the U.S. Supreme Court held that the FDA lacked authority to regulate cigarettes as nicotine delivery "devices" subject to FDA jurisdiction under the Food, Drug & Cosmetic Act, this is precisely the role that a court plays.[136] The court's task at step one is to determine statutory meaning − a task judges have the experience and institutional competence to perform without drawing on anyone else's expertise.

One popular approach to conceptualizing *Chevron*'s step one inquiry focuses on the background incentives favoring legislative delegation. The basic approach is to understand step one as creating incentives for legislative clarity and comprehensiveness and against broad delegations. On this view, if Congress wishes for courts to restrain agencies, it should use clear and unambiguous language in the legislation it passes.

[136] Food and Drug Administration v. Brown & Williamson Tobacco Corp., 529 U.S. 120 (2000). Einer Elhauge defends this result by arguing that the Court was following current enactable congressional preferences, as is appropriate where the Court reviews agency interpretations of ambiguous provisions. Einer Elhauge, *Preference Estimating Statutory Default Rules*, 102 COLUM. L. REV. 2027, 2148-54 (2002).

Justice Scalia, for example, has praised *Chevron* for creating an incentive for Congress to use clear language in statutes: "Congress now knows that the ambiguities it creates . . . will be resolved, within the bounds of permissible interpretation, not by the courts, but by a particular agency, whose policy biases will ordinarily be known."[137]

Put another way, judicial deference to an agency – triggered by the step one inquiry of whether Congress failed to use clear language to limit agency policy choices – serves as a "default rule" which, on a case-by-case basis, Congress can change.[138] Where Congress is sloppy, as it frequently is in drafting statutes, Congress and interest groups face the potential "penalty" of judicial deference – generally reaffirming the agency's view − at step two. Einer Elhauge, for example, has argued that *Chevron* doctrine allocates authority between courts and agencies in a way that is designed to ensure that the resolution of statutory ambiguity will best match current (majoritarian) government preferences.[139] In this sense, step one of *Chevron* can operate as a type of clear statement rule, designed to elicit statutory clarity from Congress where there is a majoritarian preference supporting clarity. A desirable byproduct of such approach is to channel interest group lobbying efforts to focus on Congress, not agencies or courts, making it more likely that legislative decisions better reflect majoritarian preferences.

While clear statements at *Chevron's* step one have an appealing democracy-forcing function, it approached too aggressively they invite judicial mischief and, by

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[137] Antonin Scalia, *Judicial Deference to Administrative Interpretations of Law*, 1989 DUKE L.J. 511, 517.
[138] *See id*., at 517 (describing *Chevron* as a "background rule of law against which Congress can legislate."); Merrill, *supra* note 17, at 978 (*Judicial Deference to Executive Precedent*) (referring to *Chevron* as a "default rule" which "Congress can change").
[139] Einer Elhauge, *Preference-Eliciting Statutory Default Rules*, 102 COLUM. L. REV. 2163 (2002) (arguing for preference-eliciting default rules in statutory interpretation).

hamstringing agencies on programmatic details in contexts on the specific or narrow types of issues for which congressional revision is unlikely, may undermine sound regulatory policy. Indeed on one understanding of the judicial role at *Chevron's* step one, a courts primary emphasis is on whether clear and unambiguous language prohibits or precludes a regulatory from exercising discretion in a certain a way; at the extreme, such an approach invites invites aggressive judicial attribution of clear statutory meaning as a way of limiting agency discretion and avoiding subjecting an interpretation to *Chevron* step two deference at all.[140] In contrast to this oft-criticized approach, the predominant approach of courts in reviewing an agency's interpretation at *Chevron's* step one focuses on whether a statutory gap or ambiguity exists, leaving questions about how an agency exercises discretion for resolution at *Chevron's* step two.[141]

2. Step Two as a Reason-Giving Requirement

Step two of *Chevron* assumes that the statute itself does not answer the question of whether an agency's action is valid. While many courts are extremely deferential in

[140] For a notable Supreme Court case illustrating this activist approach to applying *Chevron* step one, see INS v. Cardoza-Fonseca, 480 U.S. 421 (1987). There, the majority's step one analysis (applied to reverse the INS) was so searching that it prompted Justice Scalia to argue that it "implies that courts may substitute their interpretation of a statute for that of an agency whenever . . . they are able to reach a conclusion as to the proper interpretation of the statute." *Id.* at 454 (Scalia, J., concurring in the judgment). Justice Scalia protested that the Court's "approach would make deference a doctrine of desperation, authorizing courts to defer only if they would otherwise be unable to construe the enactment at issue. This is not an interpretation but an evisceration of *Chevron*." *Id.*

[141] *Chevron* itself embraced such an approach. 467 U.S. at 843-44 ("If Congress has explicitly left a gap for the agency to fill, there is an express delegation of authority to the agency to elucidate a specific provision of the statute by regulation . . . . Sometimes the legislative delegation to an agency on a particular question is implicit rather than explicit. In such a case, the court may not substitute its own construction of a statutory provision for a reasonable interpretation made by the administrator of the agency."). *See also* Merrill & Hickman, *supra* note 114 (adopting a delegation approach to *Chevron* step one, in which courts focus on whether a gap or ambiguity exists).

reviewing agency action at step two, most commentators today see *Chevron's* step two as co-existing with a type of reasonableness review of agency action as a way of managing the discretion exercised by the agency in the context of a legislative delegation. For example, in endorsing "hard look" review, the Supreme Court has stated that a rule

> Would be arbitrary and capricious if the agency has relied on factors which Congress has not intended it to consider, entirely failed to consider an important aspect of the problem, offered an explanation for its decision that runs counter to the decision before it, or is so implausible that it could not be ascribed to a difference in view or the product of agency expertise.[142]

The notice and comment process binds the agency legally to produce explanatory material in the form of a statement of general basis and purpose,[143] and the rigors of hard look review work to promote deliberation and accountability,[144] and protect against arbitrariness,[145] in this process. Several recent commentators emphasize such an approach to arbitrary and capricious review addresses delegation-type concerns.[146] It has also been observed that hard look review serves a "signaling" function by allowing courts to overcome their comparative informational disadvantage in assessing complex technical and policy issues vis-à-vis other branches to the extent a "court can reason that the expert government decisionmaker's willingness to provide an explanation signals that the government believes the benefits of the proposed policy are high."[147]

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[142] Motor Vehicle Manufacturers Ass'n v. State Farm Mutual Insurance Co., 463 U.S. 29, 43 (1983).
[143] *See* 5 U.S.C. §553(c).
[144] *See* Seidenfeld, *supra* note 127.
[145] Lisa Schultz Bressman, *Beyond Accountability: Arbitrariness and Legitimacy in the Administrative State*, 78 N.Y.U. L. REV. 461 (2002).
[146] *See id.*; *see also supra* note 18 and accompanying text (citing Bressman, Stack, Criddle).
[147] Matthew C. Stephenson, *A Costly Signaling Theory of 'Hard Look' Review*, 58 ADMIN. L. REV. 753, 755 (2006).

Indeed, evidence suggests that courts find attractive the kind of heightened review reflected in a delegation approach to step two. While it has been observed that in practice step two *Chevron* review is so lenient that it is almost meaningless,[148] lower courts take hard look review more seriously.[149] The first fifteen years following *Chevron* were characterized by the U.S. Supreme Court's failure to reverse an agency at step two of *Chevron*, but in at least two recent cases the Court has adopted a more rigorous approach to step two, reversing and remanding agency action where regulators failed to provide adequate reasons in making their decisions.[150] If public choice concerns justify such review in the context of federal agencies,[151] such concerns are even more salient in the context of state and local economic regulation. Moreover, two of the main rationales for strong *Chevron* deference at the federal level are inapposite to the state and local government context: the national uniformity interest in strong *Chevron* deference is simply not applicable;[152] and the unitary executive[153] is foreign to most state and local

[148] Seidenfeld, *supra* note 127, at 84. *See also* Ronald Levin, *The Anatomy of* Chevron*: Step Two Reconsidered*, 72 CHI.-KENT L. REV. 1253, 1261 (1997) (noting that as of 1997 the Supreme Court has never struck down an agency interpretation by relying squarely on *Chevron's* step two).

[149] *See* Levin, *supra* note 148.

[150] In *AT&T Corp. v. Iowa Utilities Board*, 525 U.S. 366 (1999), the Supreme Court arguably relied on *Chevron's* step two to reverse the agency's decision. Also, in *American Trucking*, the Court relied on step two in reversing and remanding the EPA's rule. Whitman v. American Trucking Ass'n., Inc., 531 U.S. 457, 468 (2001).

[151] *See* Bressman, *supra* note 18 (citing public choice concerns).

[152] Peter Strauss has advanced *Chevron* deference as a way of promoting uniformity in agency interpretations and policy approaches. *See* Strauss, *supra* note 129. Deference to a state or local regulator may further uniformity, but only within the state or local jurisdiction at issue and not at the national level.

[153] *See supra* note 17 (citing Paulsen, Merrill).

governments, where the more predominant executive governance model is governance by plural executive or by commission rather than a single executive branch official.[154]

Beyond hard look review, the kinds of delegation issues courts routinely address at *Chevron* step two have four additional implications for economic regulation. First, under *Chevron,* courts are frequently asked to address how deference relates to the presumption against preemption as an interpretive canon. While the problem presented by the state action antitrust exemption may raise federalism concerns, in the antitrust context the deference issue demands a different analysis, given that vertical rather than horizontal deference is at issue. Second, private delegations have historically called for heightened judicial review in administrative law, in large part as a constitutional avoidance mechanism. Third, as has long been recognized, courts frown on agencies providing reasons for their decisions after the fact, as occurs when an agency provides a post hoc rationale for its position in a brief filed in a judicial proceeding. Fourth, the hard look doctrine can not only extend to affirmative agency decisions to regulate, but can and should also be used to attack agency failures to act. All of these questions relate to the kinds of delegation issues that courts are called to address in the context of applying the antitrust state action exception.

To begin, courts are frequently called on to address how *Chevron* relates to federalism-oriented concerns, such as a respect for decentralized decisionmaking and

[154] For discussion of divergence between governors under state constitutions and the U.S. President, see William P. Marshall, *Break Up the Presidency: Governors, State Attorneys General, and Lessons from the Divided Executive*, 115 YALE L.J. 2446 (2006) (contrasting the federal unitary executive with the model of the state executive, which is typically plural); Jim Rossi, *Overcoming Parochialism: State Administrative Procedure and Institutional Design*, 53 ADMIN. L. REV. 551, 559 (2001) (observing that "in most states the ability of a governor to oversee executive branch policymaking is weak in comparison to the U.S. President.").

state sovereignty. The approach of those who embrace a preemption-based understanding of the state action exception, such as Squire, would see preemption of state regulation of antitrust cases – i.e., a judicial finding of no state action exception − as applying only where a court makes an affirmative finding that the regulatory purposes of a state approach conflict with the purposes of the Sherman Act.[155] However, if the state action antitrust defense is cast entirely as a preemption issue, a background presumption against preemption, requiring an affirmative finding by courts to overcome the mere fact of state and local regulation, also invites courts to define the range of regulatory actions leading to antitrust exemptions too broadly. At one extreme, given the ambiguous approach of Congress in the Sherman Act, no state or local law at all would be preempted. At the other extreme, Congress could not have intended to allowed passage of the Sherman Act to invalidate a broad range of state and local regulation at the time, including grain regulation, sewage regulation, and trolley franchises. For this reason, on its own terms a preemption approach to the state action exception provides a troubling basis for courts to use in applying state action doctrine.

As Nina Mendelson has emphasized, "the source of the tension between *Chevron* and the presumption against preemption is that Congress has failed to define explicitly whether it believes a statute preempts state law or whether it wishes an administrative agency to decide that question."[156] In the context of horizontal deference issues, deference and the presumption against preemption pull judicial scrutiny in opposite directions. Where Congress makes ambiguous delegations, Mendelson suggests that courts need to exercise their own independent judgement to resolve state law preemption

[155] Squire, *supra* note 10.
[156] Nina A. Mendelson, Chevron *and Preemption*, 102 MICH. L. REV. 737 (2004).

questions rather than defer to federal agencies at step two of *Chevron*.[157] In particular, raising some of the concerns that inform the delegation-oriented account of *Chevron*, she focuses on how this can further institutional competence and political accountability goals, as well as how this promotes agency expertise, protects against self-interest, and minimizes the prospect of arbitrary decisionmaking.[158] Of course, the state action exception addresses judicial deference to *state* – not federal – regulation. Here, the presumption against preemption and deference do pull courts in opposite directions but point in the precisely same direction – supporting deference to state regulators. In such a context, blind judicial adherence to a presumption against preemption would perversely result in not less but more deference to regulators in the state action exception context. In many respects, the deference problem presented to courts in the state action exception context is fundamentally different from that presented in other federalism contexts involving *Chevron*. Independent of any congressional decision to delegate, state and local governments have always had and retain significant regulatory powers if they choose to exercise them − as the judicially-created category of state action doctrine recognizes. Thus, in the context of the state action exception, the deference problem presented to courts is fundamentally different from that presented in other federalism contexts involving *Chevron*. That is not to say the lessons of *Chevron* are irrelevant, but there is good reason to think that the same approach to issues like federalism simply is not justified where deference to state, rather than federal, regulators is at issue. As with other *Chevron* questions, any institutional analysis of the deference problem presented by state action exception must focus on the competence of various actors and incentives

[157] *Id.* at 800.
[158] *Id.*

produced in the state lawmaking process. Given the well-accepted Madisonian account of interest group behavior in state and local politics, increased caution in deferring is in order in this context. If, as Mendelsohn argues, independent judicial inquiry is necessary to protect accountability in the context of a federal agency making a decision to preempt state regulation, an even greater level of judicial scrutiny will be necessary to protect accountability where the preemption decision hinges on the policy choice of a state or local regulator.

Nor are courts any more inclined to defer to federal delegations to state agencies. The D.C. Circuit has recognized this basic principle, and the limits of *Chevron* deference, in the context of telecommunications regulation. In response to a series of reversals on its rules intended to foster a competitive market in local telecommunications,[159] the Federal Communications Commission adopted a provisional nationwide rule subject to the possibility of local exceptions. The rules relegated to state public utility commissions the power to determine when local exceptions to access were warranted, even though Congress had specifically directed the FCC to itself consider whether the lack of access would impair the ability of an entrant to provide service. On review, the D.C. Circuit reversed the FCC's "subdelegation" of determination of an "impairment" to a state agency.[160] While the court recognized it entirely appropriate for the FCC to delegate to a subordinate within the agency, it limited subdelegation to outside parties, including state or local regulators, for fear that "lines of accountability may blur, undermining an

[159] AT&T Corp. v. Iowa Utitilies Bd., 525 U.S. 366 (1999); United States Telecom Assn. v. FCC, 290 F.3d 415 (D.C. Cir. 2002).
[160] United States Telecom. Ass'n. v. FCC, 359 F.3d 554 (D.C. Cir. 2004).

important democratic check on government decision-making."[161] The court emphasized that such subdelegation "aggravates the risk of policy drift inherent in any principal-agent relationship."[162]

Second, courts applying *Chevron* review delegations to private entities with an especially jaundiced eye. The general movement away from traditional means of regulation and towards deregulation and privatization has generated much praise for the challenge it presents to many negative aspects of the traditional regulatory state.[163] Administrative law has long recognized, however, that private delegations also present a unique set of problems – bordering, at some level, on the unconstitutional.[164] As Paul Verkuil has recent chronicled, privatization can be pursued without thwarting public values if certain inherent democratic functions are preserved by democratically accountable public officials.[165] More than two decades ago, Cass Sunstein highlighted these concerns in the context of step two of the *Chevron* framework by calling for more

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[161] *Id.* at 565-66.

[162] *Id.* at 566. The D.C. Circuit distinguished, and left open the permissibility of, subdelegations for "(1) establishing a reasonable condition for granting federal approval; (2) fact gathering; and (3) advice giving." *Id.*

[163] *See* Orley Lobel, *The Renew Deal: The Fall of Regulation and the Rise of Governance in Contemporary Legal Thought*, 89 MINN. L. REV. 342 (2005) (describing a "paradigm shift" away from top-down, command and control approach to regulation and towards a more reflexive approach to governance, placing private stakeholders at the driver's wheel).

[164] The outer limit is best summarized in Carter v. Carter Coal, 298 U.S. 238, 322 (1936) (invalidating a delegation to a district board elected by coal operators and unions that would set wages binding upon all coal producers and noting "[t]his [was] legislative delegation in its most obnoxious form; for it [was] not even delegation to an official or an official body, presumptively disinterested."). *See also* Louis L. Jaffe, *Lawmaking by Private Groups*, 51 HARV. L. REV. 201, 248 (1937) (expressing concerns with private delegations but suggesting that *Carter Coal's* emphasis on the nondelegation doctrine might be replaced by a focus on due process issues).

[165] Paul R. Verkuil, *Public Law Limitations on Privitization of Government Functions*, 84 N.C. L. REV. 397 (2006).

heightened reasonableness review of deregulatory policies.[166] As the issue of private delegations highlights, where these policies are executed entirely by private entities, and involve little or no judgment on the part of regulators – as may be the case where a legislature has delegated the setting of rates to an industry[167] – the basis for an elevated standard of review is strong, if nothing else as a type of constitutional avoidance device. As Kenneth Bamberger has recently observed, there are significant accountability benefits to courts extending basic administrative law principles to private delegations.[168]

Third, it is a well recognized tenet of administrative law that if an agency has failed to provide reasons or has provided inadequate reasons a court may not repair the deficiency by providing post hoc rationalizations. As the Supreme Court stated in *SEC v. Chenery Corp*.,

> [A] reviewing court, in dealing with a determination or judgment that an administrative agency alone is authorized to make, must judge the propriety of such action solely by the grounds invoked by the agency. If those grounds are inadequate or improper, the court is powerless to affirm the administrative action by substituting what it considers to be a more adequate or proper basis.[169]

Courts may accept post hoc explanations from agencies that "merely illuminate reasons obscured but implicit in the administrative record."[170] However, if the subsequent explanation provides an "entirely new theory" to support the agency's decision and does

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[166] Cass Sunstein, *Deregulation and the Hard-Look Doctrine*, 1983 SUP. CT. REV. 177 (advocating for a "hard look" approach to judicial review in reviewing deregulatory policies). *But see* Merrick B. Garland, *Deregulation and Judicial Review*, 98 HARV. L. REV. 505 (1985) (criticizing "hard look" review of agency decision making, especially in the deregulation context).

[167] As was the case in *Ticor*. *See supra* notes 46-50 and accompanying text.

[168] Kenneth A. Bamberger, *Regulation as Delegation: Private Firms, Decisionmaking, and Accountability in the Administrative State*, 56 DUKE L.J. 377 (2006).

[169] 332 U.S. 194, 196 (1947).

[170] Consumer Federal of America v. U.S. Department of HHS, 83 F.3d 1497, 1507 (D.C. Cir. 1996).

not "simply provide additional background information about the agency's basic rationale," it will be rejected.[171] Courts have applied this principle to reject agency rationalizations provided in briefs but not provided by the agency itself in making the initial decision subject to appeal.[172] Even government litigation positions that are advanced by the agency itself may be afforded less weight if they are only provided post hoc, on the grounds that Congress did not delegate to executive agencies the authority to justify agency decisions after the fact.[173] This principle is quite foundational to administrative law, frequently serving as a basis for agency reversal and giving agency officials "strong incentives to attend to the justifications they provide for their actions."[174] To the extent that this principle extends to the state action exception, as I argue it should below, courts should evaluate reasons after the fact by state regulators or reasons proffered by private litigants with skepticism and afford them no deference; agency positions presented ex post should be afforded less deference than agency positions taken concurrent with or prior to a decision.

Finally, the hard look doctrine, which generally would apply at *Chevron's* step two, not only addresses affirmative decisions by regulators but also provides an important rationale for extending judicial review to agency inaction – such as the failure to adopt a

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[171] *Id*.

[172] In *Christensen v. Harris County*, for example, the Supreme Court refused to extend Chevron deference to an amicus brief filed by the United States supporting the interpretation at issue. 529 U.S. 576, 582, 587 (2000). *See also* Merrill & Hickman, *supra* note 114, at 901 (noting that the Court's rationale for *Chevron* "clearly precludes giving *Chevron* deference" to interpretations that are "post hoc rationalizations provided by agency counsel such as agency briefs").

[173] *See* Kevin M. Stack, *The Constitutional Foundations of* Chenery, 116 YALE L.J. ___ (forthcoming 2007) (arguing that the *Chenery* principle – focusing on what the agency has articulated as a grounds for its actions, not only on what is permissible or rational – is based on constitutional nondelegation doctrine).

[174] *Id*., at __.

rule, to enforce a regulation, to issue a permit, or to regulate a firm's conduct − as well as affirmative agency regulatory decisions. As Lisa Bressman has argued, since an agency is susceptible to corrosive influences when it fails to act, courts can play a useful role in policing agency inaction.[175] Specifically, the failure to enforce pre-articulated regulatory goals may be reviewed under the arbitrary and capricious doctrine. As Bressman states:

> [A]dministrative nonenforcement decisions should be subject to the familiar requirement that agencies articulate reasons supporting their affirmative regulatory decisions. In addition, administrative nonenforcement decisions should be subject to the important requirement that agencies promulgate and follow standards guiding their affirmative regulatory authority. Only by subjecting agency inaction to these principles will courts help agencies resist the influences that produce arbitrary administrative decisionmaking regardless of how those influences are manifested.[176]

Just as an agency must provide reasons for taking affirmative regulatory action, where any agency fails to regulate its inaction should be subject to a reasons-giving requirement and scrutinized by courts at step two of *Chevron*.[177] Regulatory inaction can also be understood on delegation terms – an otherwise valid legislative delegation of authority is more likely to raise private delegation concerns where an agency has authority to regulate but does nothing,[178] so the justification for heightened judicial scrutiny in this context is strong. Such a principle can play an important role in the state action antitrust exception

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[175] Lisa Schultz Bressman, *Judicial Review of Agency Inaction: An Arbitrariness Approach,* 79 N.Y.U. L. REV. 1757 (2004).
[176] *Id.* at 1661.
[177] Bressman discusses two nonjusticiability doctrines in administrative law that can pose a barrier to such review: nonreviewability doctrine and standing doctrine. As she suggests, neither is an insurmountable barrier to judicial review of agency inaction. Id at 1664-75.
[178] On heightened judicial review as an avoidance mechanism for addressing the constitutionality of private delegations, see *supra* notes 163-68 and accompanying text.

context, where private firms frequently assert a state action defense against the backdrop of inaction by regulators at the state or local level.

III. THE LIMITS OF CLEAR STATEMENTS AS THE BASIS FOR APPROVING ANTICOMPETITIVE CONDUCT OR SUPPORTING DELEGATIONS

As Frank Easterbook has suggested, legal presumptions can play an important role in antitrust law, particularly where these serve as a type of gate-keeping filter for judicial consideration of antitrust claims.[179] If the state action exception doctrine is approached as providing default rules to guide judicial intervention, such presumptions could set positive background incentives in the bargaining process of state law making. The first step of the *Midcal* test – the clear articulation requirement – holds some promise in this regard. In approaching the clear-articulation requirement of *Midcal*, courts might take a lesson from *Chevron's* analysis, especially its call for modesty in attributing statutory meaning and its emphasis on clarity as a mechanism for promoting more democratic decisionmaking. The state action antitrust exemption promotes federalism values – values we endorse because they enhance democratic legitimacy; properly approached, clear statements rules skew decisionmaking towards the political process and away from judicial resolution.[180] By requiring such statements as a predicate to extending an antitrust state action defense, courts could make it more likely that a legislature is explicit about a decision to approve allegedly anticompetitive conduct or to delegate (and on what terms) such approval to a regulatory agency.

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[179] Easterbrook, *supra* note 26 (*The Limits of Antitrust*).
[180] William N. Eskridge , Jr. & Philip P. Frickey, *Quasi-Constitutional Law: Clear Statement Rules as Constitutional Lawmaking*, 45 VAND. L. REV. 593 (1992).

If a state or local legislative body endorses a clear ban on competition, leaving no role for agency regulators (or private firms) in implementing the ban, there is little for a federal court to resolve by evaluating the legitimacy of the ban; this is precisely the sort of state determination that the Sherman Act intended to leave in place, so long as it is made in a legitimate and transparent manner.[181] In such an instance, the legislature has explicitly approved the allegedly anticompetitive conduct ex ante by stating its policy of displacing competition. Assuming such a policy is explicit, clear and self-executing, a court should use a clear statement approach to make a finding that the state policy gives rise to a state action exception.

In most instances, however, a legislature will not itself have expressed a clear and comprehensive view, but will have delegated some discretion in its implementation to a regulatory agency. Assuming that such a delegation is clear in its purpose to displace competition, the legislature has met the minimum requirements for clarity, although there still may be important issues to assess regarding regulatory oversight. However, it is far more worrisome if a legislature is ambiguous about its specific purpose in delegating to an agency and a court purports to find clarity for purposes of satisfying *Midcal*'s first step. As has been observed, *Chevron's* step one invites judges to engage in the same interpretive mischief.[182] In such cases, rather than overemphasizing clarity, courts need to carefully address the scope of the delegation and the extent to which, if at all, the

[181] By contrast, if a state or local legislative body adopts a clear statement by expressly articulating policy to regulate in restraint of trade, as they do in endorsing a monopoly franchise that is rate regulated by an agency, the courts may have a very different role to play. Here the clear statement is a delegation, and a court still has to evaluate how that delegation is exercised under step two of the *Midcal* test. *See infra* Part IV.

[182] *See supra* note 140 and accompanying text (discussing *Cardoza-Fonseca* approach to *Chevron* step one).

legislature has provided guidance for the regulatory agency – an exercise that can aid the judicial inquiry into active supervision. Just as most courts applying *Chevron* do not limit their analysis at step one to whether a statute merely delegates the issue to an agency, aggressively reversing the agency where it does not and blindly deferring to the agency in any instance in which it does,[183] the clear articulation requirement of *Midcal* should not merely emphasize whether the legislature itself has articulated a general policy of displacing competition with clarity. Given that many state regulatory programs delegate discretion, sometimes with a clear purpose but only a general one, it is important for courts to define what questions remain for agency regulators to make under the statute – issues that will need to be assessed at step two of the *Midcal* test when the agency supervision role is examined.

Where the state or local legislative intent regarding the relationship between a state law and the goals of the Sherman Act is at all ambiguous, or is only general in nature, courts should refuse to attribute clear articulation of a specific legislative purpose unless there is evidence that this is what a current majority in the state would endorse. How the legislature articulates a regulatory program should play an important role in deciding whether courts review the action. "The clear articulation requirement serves an important purpose," C. Douglas Floyd writes, "by ensuring that departures from the presumptive federal competitive norm are authorized only as the result of a carefully

[183] As Cass Sunstein has stated: "An ambiguity is simply not a delegation of law-interpreting power. *Chevron* confuses the two." Cass R. Sunstein, *Interpreting Statutes in the Regulatory State,* 103 HARV. L .REV. 405, 445 (1989). A legislature can delegate clearly delegate, or can delegate ambiguously.

considered, deliberately adopted, and visible state policy."[184] As William Page has argued in some of the leading articles on state action immunity, such a clear statement heightens the visibility of legislation, encouraging participants in the political process to acquire information about and to debate policies.[185] Absent such a statement, private conduct that is consistent with or authorized by broad delegations to municipal governments or regulatory agencies would be subject to review under the Sherman Act. The key variable in such an analysis should not be the creation of a majoritarian fiction, based on a selective reconstruction of what a past legislature would have thought. Instead, where there is ambiguity, courts should focus on clear evidence of what a current majority would think, since the focus is on encouraging more legitimate democratic processes today at the state and local level.[186]

Such an approach is hardly foreign to local government law and its operation. Although largely superseded by modern "home rule" approaches to local government, Dillon's rule served the same overall goal of providing a higher level of supervision for

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[184] C. Douglas Floyd, *Plain Ambiguities in the Clear Articulation Requirement for State Action Antitrust Immunity*, 41 B.C. L. REV. 1059, 1136 (2000). Writing before *Ticor*, Floyd argued that clear articulation alone should suffice for purposes of extending state action immunity to state-wide sovereign bodies, including both legislatures and agencies. Based on a *Chevron*-based analysis of the problem, informed by the political science of interest group decisionmaking, I reject this position below, *infra* Parts III and IV, except for in the extreme cases in which nothing at all is left to others in implementing a state regulatory approach.

[185] William H. Page, *Interest Groups, Antitrust, and State Regulation:* Parker v. Brown *in the Economic Theory of Legislation*, 1987 DUKE L.J. 618; William H. Page, *Antitrust, Federalism and the Regulatory Process*, 61 BOSTON U. L. REV. 1099 (1981).

[186] *See, e.g.,* Elhauge, *supra* note 136, at 2148-54 (defending step one reversal of an agency where the agency's position does not represent "any enactable political preference"); Note, *"How Clear is Clear" in* Chevron*'s Step One*, 118 HARV. L. REV. 1987, 1706 (2005) (describing step one process of predicting current congressional majority).

municipal lawmaking.[187] This canon of statutory interpretation applied in many states to invalidate broad state delegations to municipalities, although most states have moved away from this with the growth of "home rule." The effect of the clear-articulation requirement, however, is not merely to create a federally-enforced version of Dillon's rule. Dillon's rule invalidated delegations to municipalities absent express consideration by the state legislature.[188] In contrast to Dillon's rule, which automatically validated a clear delegation, the clear-articulation requirement of *Midcal* would subject private conduct within the scope of the delegation to scrutiny under the Sherman Act.

Yet, traditional clear statement rules have their limits as they assume that a legislature itself speaks with a single purpose and voice. As Kenneth Shepsle and many others before and after him have put it, a legislature is a "they," not an "it."[189] A clear statement rule is a hermeneutic effort to get at legislative intent – to pay fidelity to past preferences, which are judicially constructed as a fiction − but a legislature having made a delegation will rarely have a clear specific intent on an issue of complex economic regulation. Courts can readily abuse clear statement rules to the extent judges use judicially-implied clear statements as a backdoor way to impose a constitutional design, allowing "judicial modesty to cloak judicial activism."[190] Moreover, a clear statement rule assumes that the major problem is the legislature, not the interest groups which interact with lawmaking bodies.

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[187] *See* Clayton P. Gillette, *In Partial Praise of Dillon's Rule, or, Can Public Choice Theory Justify Local Government Law?*, 67 CHI.-KENT L. REV. 959, 960-61 (1991).
[188] *See* Merriam v. Moody's Executors, 25 Iowa 163, 170 (1868).
[189] Kenneth A. Shepsle, *Congress is a 'They,' Not an 'It': Legislative Intent as an Oxymoron*, 12 INT'L REV. OF LAW & ECON. 239 (1992).
[190] Eskridge & Frickey, *supra* note 180, at 646.

By contrast, a different type of interpretive canon – a preference-eliciting default rule – provides a better way of conceptualizing the clear-articulation requirement in state action immunity. These parallels calls for a "penalty default rule" in judicial interpretation of certain types of statutes: Where a court interpreting a statute is unsure of legislative intent, the court adopts the interpretation of the statute that is most unfavorable to the interest group which is most likely to persuade the legislative body to reverse the judicial interpretation.[191] Much as penalty default rules in contract law are designed to elicit better information in future contracting,[192] such a preference-eliciting approach encourages a different type of private behavior in future lawmaking processes. In his work on statutory interpretation, Elhauge envisions a preference-eliciting approach as influencing private behavior to procure more explicit legislative action in the future, which will increase the accountability of the political process.[193] He observes that such an approach is especially suitable to statutes that involve exceptions favored by powerful interest groups, such as tax and antitrust legislation.[194]

In contexts where the legislature is itself clear and specific regarding allegedly anticompetitive conduct, the clear articulation requirement in state action antitrust exception can serve precisely this purpose. However, understood as a preference-eliciting default rule, a clear-articulation requirement should not to give rise to automatic state action immunity where a legislature is ambiguous and arguably could foresee some regulatory activity, as has occurred in a variety of past cases. It has been observed that

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[191] Elhauge, *supra* note 139 (*Preference-Eliciting Statutory Default Rules*).
[192] Ian Ayres & Robert Gertner, *Strategic Contractual Inefficiency and the Optimal Choice of Legal Rules*, 101 YALE L.J. 729 (1992).
[193] Elhauge, *supra* note 139 (*Preference-Eliciting Statutory Default Rules*).
[194] *Id.* at 2207.

courts repeatedly place an emphasis on foreseeability as the basis for inferring clarity in a legislature's purpose to displace the Sherman Act: courts seems to equate a grant of authority, or a delegation to an agency, with a clear purpose to displace competition under the Sherman Act.[195] A penalty-default clear statement rule would afford ambiguity a purpose that the interest groups most likely to reverse the interpretation (i.e., those with monopoly power in an industry) would disfavor – here, antitrust enforcement. Interest groups may be successful in persuading state and local lawmakers to adopt an antitrust exemption for industries, but legislatures should be expected to use clear and unmistakable language in supplanting antitrust laws with regulation and especially in making delegations to implement such regulation to local governments or regulatory agencies. Beyond clear and unmistakable statutory terms, however, courts must recognize where discretion, even constrained discretion, remains for state regulators.[196] Indeed, the risks of judicial overreaching at *Midcal's* step one are far more significant than overreaching at *Chevron's* step one, since they involve federal judicial interpretation of state and local legislation.

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[195] *See* FTC STATE ACTION REPORT, *supra* note 4, at 2 (condemning expansive interpretation of "clear articulation" by many federal courts).

[196] Hence, by arguing for a modest penalty default rule approach, I am not endorsing a hypertextualist approach to discerning meaning, in which federal courts rely almost exclusively on dictionaries, rules of grammar, and canons of construction to determine when a state legislature has clearly articulated a policy of displacing competition. For a discussion of this analogy in the *Chevron* context, see Richard J. Pierce, Jr., *The Supreme Court's New Hypertextualism: An Incoherence to Cacophony and the Incoherence in the Administrative State*, 95 COLUM. L. REV. 749 (1995). Instead, I am urging federal courts to draw on the full range of tools available to them to discern meaning, but to exercise caution against implying clarity where none exists by construing ambiguous statutes against those who stand to immediately benefit from such clarity and who are in a position to lobby for clarity. In the state action exception context, that will typically be the firms that claim that federal antitrust laws do not apply to them.

This has two implications. First, courts should be reluctant to read detail in state and local statutes as a way of constraining discretion, although such detail can play an important role in identifying whether a program of regulatory supervision has standards.[197] Second, any clear statement at *Midcal's* step one should limits its focus on the extent to which a legislative delegation is explicit in its purposes. To the extent that courts reduce the state action antitrust defense to foreseeability under *Hallie*, based on implied legislative intent,[198] application of the state action defense would benefit the interest groups most likely to lobby for ambiguous delegations. By encouraging firms to lobby for antitrust exclusion in state legislation, and leaving courts to clean up ambiguity through their aggressive attribution of clarity, state action immunity can have harmful forum selection effects. For example, a state restructuring plan that envisions a scheme of competitive restructuring as displacing antitrust enforcement could eviscerate the competitive norms of the antitrust laws, regardless of how such a scheme actually organizes the industry and monitors firm behavior. Antitrust federalism allows positive regulation by decentralized governmental bodies, but it does not authorize raw state repeal of federal antitrust law through ambiguous delegations or even through plain language overrides of the Sherman Act that depend on decisions of regulators.[199] Thus, to the extent the preference-eliciting default rule interpretation of state action immunity eviscerates the active scrutiny requirement, it concedes too much. This result is not

[197] As I suggest below, such emphasis on detail would more appropriately occur in evaluating active supervision. *See infra* Part IV.
[198] *See supra* notes 42-45 and accompanying text.
[199] William H. Page & John E. Lopatka, *State Regulation in the Shadow of Antitrust:* FTC v. Ticor Title Insurance Co., 3 SUPREME COURT ECON. REV. 189 (1993).

required by judicial deference or antitrust federalism, and may prove harmful to social welfare.

While the parallel to *Chevron's* step one provides a useful interpretation of *Midcal* step one, there is clearly a difference between a statutory gap, as *Chevron* addresses, and identifying a legislative purpose, as *Midcal* emphasizes. *Chevron* excuses all delegations, including those that are both implicit and explicit; *Midcal* only allows explicit delegations. At the same time, it would be a mistake to end the judicial inquiry here, as if a clear statement approach can provide a full analysis. Of course, clarity at step one can end the inquiry under *Chevron*, to the extent an agency renders an interpretation that contravenes clear statutory language, but identification of a clear legislative purpose, especially a clear purpose to delegate implementation of clear general goals to regulators, should not end the inquiry into whether a state action antitrust exception exists. Where there is some kind of a delegation, a preference-eliciting penalty default rule is only the beginning; some clear articulation of purpose may be necessary, but it is not a sufficient basis for suspending judicial review of market conduct under the Sherman Act. As I argue below, some evaluation of how the state engaged in regulatory oversight under a legislative delegation is also necessary.

IV. *MIDCAL*'S STEP TWO: REASONS FOR FOREGOING ACTIVE-SUPERVISION

Step two of *Chevron* also can help courts to understand the state action antitrust defense especially in the context of state regulatory inaction. As the U.S. Supreme Court stated in *Ticor,* and the Ninth Circuit embraced in *Columbia Steel Casing,* active supervision of state regulators' conduct, as well as a clear statement of purpose, is

required in order to trigger a state action defense from antitrust enforcement. However, many appellate courts remain astonishingly deferential to regulators in applying the active-supervision prong of the *Midcal* test. Consistent with the Supreme Court's pronouncements in the context of municipal regulation, these appellate courts effectively read out of state action antitrust doctrine any serious scrutiny of regulatory supervision, focusing instead on whether a decentralized legislative body has delegated authority to supervise private conduct to an agency. In most cases, *potential* supervision of conduct alone has been sufficient to trigger a state action exemption from enforcement of the antitrust laws.[200]

As I will argue, the mere potential for agency regulation, as may be present where a legislature has delegated authority to an agency, is never sufficient to extend a state action antitrust exemption. Further, focusing on past regulatory actions alone in evaluating the state action exception can be misleading. A focus on reasons provided by regulators, as a delegation-based approach to *Chevron's* step two recommends, would allow courts to develop a more principled approach to state action antitrust defense cases, especially where they are reviewing private conduct that is not subject to regular government intervention.

A. The Necessity of an Active-Supervision Inquiry

Some commentators argue that clear articulation of a policy to displace competition by a state-wide regulator should suffice for purposes of extending state action immunity. As C. Douglas Floyd notes, "state agencies frequently do possess

[200] For example, potential regulation by a utility commission was found by the Tenth Circuit to be sufficient in the *Trigen* case, discussed *supra* notes 67-70 and accompanying text.

authority, as a matter of state law, to prescribe competition policy for the state as a whole under general delegations of authority from the state legislature."[201] Thus, he suggests, "the agency's clear articulation of state policy within the scope of its delegated authority should suffice in itself to satisfy the clear articulation component . . . ."[202]

Within a state, as in other lawmaking processes, private interest groups frequently face incentives to lobby lawmakers to secure benefits, and may prefer open-ended regulatory schemes which leave details to be worked out by an agency firm-by-firm. As Herbert Hovenkamp has observed, "Regulation by state and local government is not only pervasive, but it is also probably more susceptible to political influences than federal regulation is."[203] The more local the lawmaking process, the less costly it is for powerful interest groups to organize and influence the process, but the process can have serious spillover effects for non-participants. At the local level, rent seeking may be more visible, but it also may be more stable, given the ability of private firms to exploit the political as well as the regulatory process. Thus, if courts are to focus on the quality of the political process leading to enactment of a market restraint, the now defunct municipal-state distinction is sensible. It would require courts to apply more scrutiny to local, as opposed to state, regulations in restraint of trade.

While Floyd is correct that state and municipal process may demand different degrees of judicial scrutiny, his recommendation that state agencies be allowed to opt out of the antitrust law with a clear articulation alone throws the baby out with the bathwater. Allowing clear-articulation of a policy to suffice for purposes of bringing private conduct

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[201] Floyd, *supra* note 184, at 1136.
[202] *Id.*
[203] Herbert Hovenkamp, *Antitrust and the Regulatory Enterprise*, 2004 COLUM. BUS. L. REV. 335, 346.

outside of the scope of the antitrust laws would greatly broaden the scope of state action antitrust doctrine. It would present particularly inviting immunity for industries in which state legislatures have made broad delegations to implement regulation to administrative agencies. Moreover, it would encourage powerful industry-based interest groups to seek such broad delegations with little or no oversight under the antitrust laws.

Rather than allow clear articulation to exempt state sovereigns from antitrust enforcement, much as *Chevron* step one ends the judicial review inquiry for federal agencies with clear statutory statements, a *Chevron* analysis informed by the economics of interest group decision making illustrates why, under *Midcal*, it is always necessary for a court to address the step two inquiry. At the federal level, where interest group exploitation of the legislative process is less likely, it makes sense for courts to end their inquiry with an assessment of the consistency of a federal agency's conduct with clear statutory language. However, as politics move from the federal context to the state and local level, the economics of interest group decision making the prospect of strategic use of the lawmaking process more likely. Firms might use the lawmaking process to extract clear statements as a strategy to opt out of antitrust enforcement, making it more likely that the process of such lawmaking will exclude interstate interests which suffer harms from anticompetitive conduct. For this reason, under *Midcal*, unlike *Chevron*, it will always be necessary for a court to arrive at step two of the inquiry. Courts that relax step two of the test take the *Chevron* deference analogy too far; the two steps of analysis in

Midcal differ structurally from *Chevron* given that state action antitrust doctrine is concerned with federal court deference to state, not federal, regulation.[204]

As *Ticor* would suggest,[205] it is incumbent on federal courts to take step two of the *Midcal* analysis seriously. The Ninth Circuit has recognized the importance of active supervision in restructured network industries by applying *Midcal* in a way that contrasts markedly with the approaches of the Eighth, Tenth and Eleventh circuits.[206] *Columbia Steel Casing*, a leading Ninth Circuit case on the topic, embraces a skeptical stance to a claim of a state action antitrust defense in a partially deregulated electric power market.[207] There, the state of Oregon had clearly expressed a legislative policy to remove market competition by authorizing regulators to approve allocations of service territories.[208] However, *Midcal* and *Ticor* suggest that what matters in judicial filtering in the consideration of antitrust claims is not only the legislature's clarity in delegating to the regulator but also what the regulator does in exercising its discretion. Recognizing this, the Ninth Circuit properly refused to extend a state action antitrust defense to a utility's purported anticompetitive conduct in dividing Portland into exclusive service territories, given that regulators had not made firm-specific decisions to displace competition with regulation.[209] Although the utility claimed that its conduct was consistent with previous contracts and orders, agreed to under generally delegated

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[204] In this sense, a *Chevron*-type analysis of the state action antitrust exception leads me to a fundamentally different conclusion than Phil Weiser, who advocates higher levels of judicial *Chevron* deference to state regulators interpreting federal law. *See supra* note 19.
[205] *See supra* notes 46-50 and accompanying text.
[206] *See supra* notes 67-108 and accompanying text.
[207] Columbia Steel Casing, Inc. v. Portland General Electric Co., 111 F.3d 1427 (9th Cir. 1997).
[208] *Id*. at 1433 n.2.
[209] *Id*. at 1441-42.

ratemaking authority, the only way the regulator could have mandated service territories was pursuant to a statute under which the regulator had not acted.[210] Mere "state authorization, approval, encouragement, or participation in restrictive private conduct confers no antitrust immunity," the Ninth Circuit explained.[211]

If a clear articulation of purpose alone were sufficient to provide a shield from the Sherman Act, this would create perverse incentives for interest groups in the state and local lawmaking process. It would allow select, powerful private interests to lobby lawmakers for a delegation under a clear statutory language (however broad) and then engage in conduct that completely escapes the scrutiny of both agency regulators and courts – even where the conduct would otherwise be anticompetitive under the Sherman Act. Thus, any delegation to state and local regulators must also be examined under step two of *Midcal*.

B. Requiring Reasons for Inaction

A *Chevron* analysis also sheds light on what the judicial assessment of active supervision should ideally entail. Commentators writing on *Chevron* recognize that step one typically focuses on an agency's authority, whereas step two assumes authority but focuses on the reasonableness of agency decision.[212] In other words, only where Congress has not delegated authority to an agency, does a court even get to step two under *Chevron*.

Given that step one of the inquiry focuses on authority or jurisdiction, while step two focuses on reasonableness, it would seem unduly deferential if a court simply

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[210] *See id*. at 1442.
[211] *Id*. at 1440-41 (quoting Phonetele, Inc. v. American Tel. & Tel. Co., 664 F.2d 716, 736 (9th Cir. 1981) (other citations omitted)).
[212] *See* Seidenfeld, *supra* note 127; Levin, *supra* note 148.

deferred to any agency action that falls within the agency's power to regulate. In fact, for the same reason that courts must always arrive at step two of the state action inquiry, judicial deference to regulatory power, or the potential for regulation, without more invites interest group manipulation of the regulatory forum for enforcement of competition law. The U.S. Supreme Court took a particularly egregious misstep in this direction in *Motor Carriers*, in which the U.S. Department of Justice accused truckers of horizontal price fixing.[213] The Court rejected that antitrust claim under *Midcal*, on the grounds that state ratemaking commissions approved rate proposals prepared by truckers. It reasoned that mere authority to regulate, absent any legislative requirement[214] or prearticulated criteria,[215] is sufficient to extend a state action exception. However, even where the legislative delegation at issue may be clear, it does not follow that the regulator has in fact exercised authority in ways that are consistent with its pre-articulated standards or, if there are none, with the pro-competitive goals of the Sherman Act. Allowing state action antitrust doctrine to preclude antitrust enforcement in such circumstances creates strong incentives for delegation to state regulators with little or no guarantee that such authority is exercised in ways that promote federalism or social welfare, let alone competition.

If monopolistic conduct warrants any scrutiny under antitrust federalism, appellate courts must depart from their current and past practice of ignoring the active-

[213] Southern Motor Carriers Rate Conference, Inc. v. U.S., 471 U.S. 48 (1985).
[214] *Id.* at 61 (Noting that "a state policy that expressly *permits,* but does not compel, anticompetitive conduct may be 'clearly articulated' within the meaning of *Midcal.*") (emphasis in orginal).
[215] "The details of the inherently anticompetitive rate-setting process . . . are left to the agency's discretion. The State Commission has exercised its discretion by actively encouraging collective ratemaking among common carriers." *Id.* at 64

supervision requirement. Put simply, an opportunity for regulation is not the same as active supervision − although courts seem to consistently reach this conclusion. The opportunity for regulation is a first step of the active-supervision analysis, but it hardly concludes it.[216]

Ticor clarifies that courts must assess how frequently, and under what circumstances, supervisory authority is exercised by regulators. For example, the Second Circuit correctly refused to extend a state action antitrust exemption to a challenge to an output cartel permitted by New York's legislation implementing a tobacco settlement.[217] The legislation was clear and express in its purpose to implement market-share allocations in the sale of cigarettes, but the Second Circuit criticized the state for failing to articulate either a competitive or anticompetitive rationale for the policy.[218] Regardless of whether the clear-articulation requirement had been met, and whether the cartel was foreseeable under *Hallie*, the Second Circuit refused to extend a state action exemption due to a lack of active supervision, as is required by the second prong of *Midcal*. As the court observed, neither the New York statutes, the settlement, nor any other regulation envisioned active supervision of pricing under the cartel. Given "no

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[216] Raising a similar concern, the FTC *Report of the State Action Task Force* states, "One recurring problem involves the failure to distinguish between authorizing classes of activity and forming state policy to displace competition." FTC STATE ACTION REPORT, *supra* note 4, at 26.

[217] Freedom Holdings, Inc. v. Spitzer, 357 F.3d 205 (2d Cir. 2004).

[218] *Id*. at 229-30. The court was not convinced by the health benefit claims made by the state in the course of litigation, and observed that the only public discussion of the effect of the market-share provisions was to increase prices and to discourage young people from smoking – the precise type of cartel that the Sherman Act condemns. *Id*. at 30. In an order on rehearing, the court clarified: "a court must find under this [clear-articulation] prong that the state did not inadvertently include anticompetitive activities in some larger scheme. For this reason, it is important that a state enunciate its intent to displace competition when it means to do so." Freedom Holdings, Inc. v. Spitzer, 363 F.3d 149, 156 (2d Cir. 2004) (order on rehearing).

mechanism" for reviewing the reasonableness of pricing decisions or monitoring market conditions,[219] the court concluded "New York has failed to provide for any state supervision, much less active supervision, of the pricing conduct of cigarette manufacturers under the anticompetitive market structure . . . ."[220] It further observed, "Absent such a program of supervision, there is no realistic assurance that a private party's anticompetitive conduct promotes state policy, rather than merely the party's individual interests."[221]

Recognizing the important role an active-supervision inquiry plays in antitrust federalism, the Ninth Circuit has also refused to apply a state action antitrust defense on this ground in the context of deregulated electric power markets. The court allowed Snake River Valley Electric Association, an electrical cooperative, to sue an investor-owned utility for anticompetitive refusing access to essential transmission facilities, rejecting the utility's claim to a state action antitrust exemption.[222] The utility argued that the state regulatory scheme clearly envisioned the utility refusing to wheel – to the extent the state had adopted a clear policy to displace competition among electric suppliers – but the Ninth Circuit did not allow this to trigger an antitrust defense. Under Idaho state

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[219] 357 F.3d at 231.

[220] *Id*. at 232.

[221] *Id*. at 232 (quoting Patrick v. Burget, 486 U.S. 94, 101 (1988)). An earlier Third Circuit case reached a similar conclusion, noting that the state "lack oversight or authority over the tobacco manufacturers' prices and production levels. These decisions are left entirely to private actors." A.D. Bedell Wholesale Co. v. Phillip Morris, Inc., 263 F.3d 239 (3d Cir. 2001). However, that same case extended *Noerr-Pennington* immunity to the settlement, noting that government settlements are no different in form from other types of legislative lobbying. *Id.* at 253-54. For criticism of this approach, see RICHARD A. NAGAREDA, MASS TORTS IN A WORLD OF SETTLEMENT 205-07 (2007). For a popular press account of the significant financial stakes in this antitrust dispute, see Roger Parloff, *Is the $200 Billion Tobacco Deal Going Up in Smoke?,* FORTUNE, Mar. 7, 2005, at 136.

[222] Snake River Valley Elec. Ass'n v. Pacificorp, 238 F.3d 1189 (9th Cir. 2001).

law, the utility could decline the customer's wheeling request without the substantive review of a state agency or state courts, but the court reasoned that "[t]his is the type of private regulatory power that the active-supervision prong of *Midcal* is designed to prevent."[223] Thus, the Ninth Circuit reasoned, a self-policing regulatory scheme may not require active supervision to qualify for a state action antitrust exemption,[224] but where the regulator has discretion to exercise active supervision it is an appropriate inquiry for a court. Similarly, perhaps signaling a departure from the deferential approach it previously had embraced in the electric power context,[225] the Tenth Circuit refused to extend a state action antitrust defense to lock-up telephone contracts between Southwestern Bell that were "neither mandated, nor authorized, nor reviewed, nor even known" about by state regulators.[226]

Cognizant of the potential gap that a low active-supervision threshold can create, some lower courts recognize that active supervision "would be satisfied if the state or state agencies held ratemaking hearings on a consistent basis."[227] Such an inference would be a good starting point for judicial analysis of the application of antitrust laws in a restructured network environment. Courts have a long history of allowing the existence of consistent ratemaking hearings at the state or local level to give rise to a state action antitrust exemption. In *Ticor*, for instance, the Supreme Court found it relevant that the

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[223] *Id*.
[224] *Id*. at 1194 (citing Liquor Corp. v. Duffy, 479 U.S. 335, 344 n. 6 (1987) and FTC v. Ticor Title Ins. Co., 504 U.S. 621, 640 (1992)).
[225] *See supra* notes 67-70 and accompanying text.
[226] Telecor Communications, Inc. v. Southwestern Bell Telephone Co., 305 F.3d 1124, 1140 (10th Cir. 2002).
[227] *See* Green v. People's Energy Corp., 2003-1 Trade Cases (CCH) ¶ 73,999 (N.D. Ill. 2003) (finding active supervision where lengthy hearings were held on gas supplier's rates on a consistent basis).

Wisconsin state regulatory body had not held rate hearings prior to approving on jointly filed insurance rate.[228] Thus, extending a presumption of a state action antitrust exemption, and against judicial intervention, in the context of rate hearing is appropriate.

Mere private contracts, however, do not meet this standard. For example, a contract provision prohibiting a customer from entering into the electricity market as a competitor in the future, offered by a utility in exchange for a discounted rate, is not protected by the state action antitrust defense.[229] For similar reasons, mere private filings of contracts or tariffs with a regulatory agency, without active regulatory scrutiny or oversight, would not meet the active-supervision requirement under a delegation-based account. Without meaningful agency review of the specific private conduct at issue, the state action antitrust defense can be abused by private firms in a deregulatory environment.[230] The factors that should guide courts include how frequently agencies monitor private activities, whether agencies have authority to enforce standards through the imposition of penalties, and whether agencies have adequate resources to engage in meaningful monitoring and enforcement. When in doubt, if a regulatory system risks the imposition of spillover effects on non-participants, the presumption should be against invoking a state action antitrust defense.

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[228] 504 U.S. at 629-31.

[229] United States v. Rochester Gas & Elec. Corp., 4 F.Supp. 2d 172, 176 (W.D. N.Y. 1998).

[230] As the FTC *Report of the State Action Task Force* observes:

> Active supervision requires the state to examine individual private conduct, pursuant to that [clearly articulated] regulatory regime, to ensure that it comports with that stated criterion. Only then can the underlying conduct accurately be deemed that of the state itself, and political responsibility for the conduct fairly be placed with the state.

FTC STATE ACTION REPORT, *supra* note 4, at 54.

Courts must be true to the overall federalism purposes of the state action antitrust exemption in interpreting the active-supervision requirement. Fidelity to federalism would not limit assessment of supervision to state regulation only, but would also include other regulatory bodies, such as municipalities. In addition, fidelity to federalism would require some attention to the process which gives rise to regulatory supervision. If the purposes of regulatory action overlap with the overall consumer welfare goals of the Sherman Act, perhaps some degree of deference to supervision by the state or local regulator is appropriate. However, if the purpose is blatantly protectionist, in ways that do not even arguably improve consumer welfare and that impose spillover costs on those in other jurisdictions who have not participated in the process leading to the adoption of regulation, intervention of the antitrust laws is entirely appropriate. A preference-eliciting default rule would align private incentives to ensure more explicit procurement of state action immunity via legislation and regulatory activity.

In contrast to the Eighth, Tenth and Eleventh Circuits, the Ninth Circuit correctly makes an affirmative finding of active supervision by the regulator a predicate to any finding of a state action antitrust exemption, even in deregulated markets. However, a more recent Ninth Circuit case addressing the state action antitrust defense in the very same antitrust claim illustrates how readily the active-supervision prong will be undermined if courts allow it to hinge entirely on the nature of the regulatory program approved by a state legislature rather than what regulators do in implementing that program. On the heels of the court's recognition that there was no state action defense in the first *Snake River Valley Electric Association* case,[231] the Ninth Circuit extended state

[231] *See supra* notes 222-24 and accompanying text.

action immunity to the same allegedly anticompetitive conduct.[232] Following the first judicial finding of no state action, which allowed antitrust litigation to go forward, the Idaho legislature intervened by amending its Electric Supplier Stabilization Act, under which the utility had previously declined a wheeling request absent agency review.[233] The amendments allowed an electric supplier to refuse to wheel power if the requested wheeling "results in retail wheeling and/or a sham wholesale transaction," subject to review of the state regulatory agency.[234] In addition, the Idaho legislature prohibited competing suppliers from serving customers or former customers of other electric suppliers unless the competing supplier petitions the Idaho regulator and the regulator issues an order allowing the service.[235]

In addressing this legislative intervention, the Ninth Circuit held that, unlike the previous statutory arrangement, which left the decision not to wheel entirely to private choice, the amended statute "has not left unregulated a private preserve without competition" and thus meets the active-supervision requirement for extending a state action antitrust exemption.[236] The Ninth Circuit emphasized that the Idaho statute precluded a private utility from wheeling without a contrary decision by the state regulator.[237] The result of this ruling is that statutes and regulations that prohibit competitive conduct can eviscerate any active-supervision requirement.[238] In effect, on

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[232] Snake River Valley Electric Association v. PacifiCorp., 357 F.3d 1042, 1048 (9th Cir. 2004).
[233] *Id*. at 1048.
[234] Idaho Code § 61-332D(1).
[235] Idaho Code §61-334B.
[236] Snake River Valley Elec. Ass'n, 357 F.3d at 1049.
[237] *Id*. at 1048-49.
[238] As was allowed by the Eleventh Circuit in the *TEC Cogeneration* case. *See supra* notes 79-84 and accompanying text.

this approach if a private firm is successful in lobbying for a statute that prohibits it from engaging in competitive conduct, it would be immune from antitrust challenge, even if that legislation occurs in the context of a pending antitrust challenge.

Recently, the *FTC State Action Report* elaborated on the benefits of a process based approach to assessing state active supervision in the state action context, as requiring: a) "the development of an adequate factual record, including noticed and an opportunity to be heard"; b) "a written decision on the merits"; and c) "a specific assessment – both qualitative and quantitative – of how private action comports with the substantive standards established by the state legislature."[239] While the FTC did not explicitly reference administrative law principles, the connection seems obvious and is worthy of attention by antitrust scholars, litigators and decisionmakers. Paying attention to agency actions and history is a start to an active supervision inquiry, but a step two *Chevron*-type inquiry in state action antitrust analysis might give meaningful content to the process-based approach urged in the recent *FTC State Action Report*. Instead of focusing on actions, *Chevron's* step two focuses on process and reasons. In the antitrust context, if a state or local agency fails to provide basic standards for evaluating inaction, presumptively it would seem that antitrust enforcement should proceed. Courts might create an exception where the actions of the regulator illustrate the regulator's capacity and willingness to supervise markets. These actions might include a history of regulatory intervention in setting rates or regulating industry structure, assuming this approach remains in effect. However, absent reasons given ex ante by state or local officials, within the scope of the regulators' discretion, courts should generally proceed to apply

[239] FTC STATE ACTION REPORT, *supra* note 4, at 55.

antitrust law to the private conduct at issue. Where state or local officials provide reasons for inaction that are in tension with the goals of federal antitrust laws, courts should require those reasons to be given ex ante in the state regulatory forum, where they will be subject to judicial review. Further, for purposes of extending a state action antitrust defense, a court should require those reasons to be consistent with the regulatory framework and to meet minimal reasonableness standards.

For example, consider state and local bans on competition. These bans exist in a variety of industries, but perhaps they are most visible in industries such as electric power, where competition exists in the deregulated wholesale market, but retail markets are left to the discretion of state regulators. Many states have banned retail electric power competition outright, allowing incumbent electric utilities, regulated under traditional cost-of-service principles, to provide service without the competitive threat of new entrants. To date, such bans on retail competition have avoided antitrust challenge under the Sherman Act given the state action exception.[240]

However, casting the antitrust state action exception as focusing on delegation issues suggests that, while state and local governments have considerable leeway to ban competition in various industries, competition bans are not prima facie valid. Under a delegation approach, the significance of competition bans will depend on *who* – a legislature or a regulatory agency − makes the basic decision to ban competition. A state legislature can, as a sovereign body, make that decision without itself providing reasons, assuming that whatever ban it enacts is self-executing and not contingent on decisions

[240] *See supra* notes 79-84 and accompanying text (discussing the Eleventh Circuit's opinion in *TEC Cogeneration*).

delegated to governmental agencies or private parties.[241] At the same time, if a competition ban enacted by a state legislature is intended to undermine national markets, extending a state action exception to antitrust enforcement would be inappropriate under the Supremacy Clause. For example, in operation state bans on competition may pose a conflict with national regulatory approaches (such as the deregulated wholesale market).[242] To the extent this is so, if state regulators have failed to address this conflict or to pursue legitimate state regulatory objectives, federal courts should be wary of a private firm's invocation of a state action antitrust defense even by the state legislature.

At the same time, a delegation approach recognizes that there must be some outer limit on legislative decisions to ban competition. For example, if a legislative decision to

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[241] As I have argued elsewhere, the dormant commerce clause can serve as the outer limit for such exercises of legislative power, such as where a state legislature imposes spillover costs on those who do not have the opportunity to participate in the lawmaking process. *See* Jim Rossi, *Political Bargaining and Judicial Intervention in Constitutional and Antitrust Federalism*, 83 WASH. U.L.Q. 521 (2005). There I also argue that courts examine spillover effects of regulation and legislation in assessing whether to extend the state action exception by focusing on the lawmaking process. *Id*. at 567-68. My proposal there is similar to Squire's focus on the fairness of process as a basis for scrutinizing state regulations that set prices, see *supra* note 109, but this Article's emphasis on the delegation issues presented in state and local regulatory processes clearly advises in favor of more aggressive judicial scrutiny in other regulatory contexts than his proposal would endorse.

[242] The Federal Trade Commission has identified several ways in which the failure of state regulators to conform to wholesale markets, represented at the extreme by states that have banned retail competition to favor traditional rate regulation, limit the benefits of competition from wholesale electric power restructuring. FEDERAL TRADE COMMISSION, COMPETITION AND CONSUMER PROTECTION PERSPECTIVES ON ELECTRIC POWER REGULATORY REFORM: FOCUS ON RETAIL COMPETITION (September 2001), available at http://www.ftc.gov/reports/elec/electricityreport.pdf. For example, state restrictions on power plant and transmission line siting have limited the benefits from regional wholesale power markets. *Id.* at 22-28. State standard offer service programs have impaired new entrants and limited the benefits of wholesale competition for retail customers, especially smaller residential customers. *Id.* at 43-51. Stranded cost recovery allowed by state regulators has also preserved the grip over consumer welfare held by traditional state monopolists while they simultaneously benefit from wholesale competition. *Id.* at 51-55.

ban competition also authorizes collusive behavior among private actors, private delegation concerns are implicated and judicial scrutiny is warranted.[243] Where a competition ban operates within the context of a governmental delegation, as did Idaho's ban (which allowed state regulators to exercise discretion to grant exceptions),[244] the state's decision to ban competition warrants careful scrutiny. It would seem that the most democratically elected officials within a state government, such as a state legislature or governor, should have the authority to ban state or local competition without providing elaborate reasons ex ante. Yet, where there is less majoritarian accountability (as may exist when state or local agency regulators given reasons), there is also much more to be gained from a judicially-imposed reason-giving requirement. At a minimum, a state regulatory agency should be expected to articulate such reasons – either ex ante (before adopting a competitive ban) or post hoc (such as in an amicus brief) – as a condition to a court approving the extension of an antitrust state action exception.

Another problem that the reason-giving approach to state action exception can help courts to address is market-based tariffs. In several contexts, including natural gas, electric power and telecommunications regulation, federal regulators have replaced traditional cost-of-service regulation (which set service prices based on costs following an elaborate hearing) with so called "market-based rates" – tariffs filed by firms that are approved by federal regulators based on non-cost criteria, frequently without any public

[243] As Herbert Hovenkamp observes, "a state could not simply pass a statute authorizing building contractors to fix prices and then leave them free to do so entirely on their own." HOVENKAMP, *supra* note 55, at 233.
[244] *See supra* note 37 and accompanying text.

hearing on the setting of the firm's price.[245] Such tariffs allow firms the flexibility to respond to market forces, while also allowing regulators some opportunity to monitor prices and terms of service in order to protect the public interest.[246] Federal courts have addressed the appropriateness of antitrust litigation where federal courts accept such tariffs, adopting a very deferential approach to regulators – one that seems to allow the stamp of federal regulatory approval of market rates to serve as a "filed rate" defense to antitrust litigation.[247] State regulators have also begun to implement market-based rates in many contexts.[248] For example, Texas has implemented a market-based rate filing system in its deregulated electric power market, in which firm prices are set based on market transactions rather than following a traditional cost-of-service hearing. A federal district court in Texas rejected an antitrust challenge to allegedly monopolistic behavior of a firm based on the claim that Texas' regulatory system provided sufficient regulatory oversight to invoke a filed rate defense.[249] While the district court relied on the filed rate

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[245] *See* David B. Spence, *The Politics of Electricity Restructuring: Theory v. Practice*, 40 WAKE FOREST L. REV. 417 (2005) (describing adoption of market-based retail rates for electric power at the state level).

[246] *See* Jeffrey McIntyre Gray, *Reconciling Market-Based Rates with the Just and Reasonable Standard*, 26 ENERGY L.J. 423 (2005) (noting that a presumption of "just and reasonable" rates should attach where there is evidence of competitive markets at the time of contract formation, but that if rebutted a review of market-based rates may be appropriate); Gerald Norlander, *May the FERC Rely on Markets to Set Electric Rates?*, 24 ENERGY L.J. 65 (2003) (arguing that FERC's market-based rate policy violates the Federal Power Act's requirement that regulators allow only "just and reasonable" rates).

[247] *See* Town of Norwood v. New England Power Co., 202 F.3d 408 (1st Cir. 2000). The filed rate defense differs from the state action exception in that it focuses on horizontal (not vertical) conflicts between courts and federal (not state) regulators. In a previous article, I have argued that such an absolutist approach to the filed rate defense in antitrust claims is flawed. *See* Jim Rossi, *Lowering the Filed Tariff Shield: Judicial Enforcement for a Deregulatory Era*, 56 VAND. L. REV. 1591 (2003).

[248] *See* Spence, *supra* note 245.

[249] Texas Commercial Energy v. TXU Energy, Inc., 413 F.3d 503, 508 (5th Cir. 2005) (stating that "courts have consistently applied the filed rate doctrine in a number of

doctrine, the court was wrong to apply this defense to shield the private firm from antitrust scrutiny based on state or local regulatory action – as the firm's defense involved a claim that there is a vertical, not a horizontal, regulatory conflict.[250] If such issues are properly addressed as delegation issues within the state action antitrust exception, federal courts will be more likely to protect against abuses of monopoly power. Presumably, market-based filing systems are based on pro-competitive goals – goals that are generally co-extensive with the purposes of the Sherman Act. However, market-based rate file-and-approve system give little record for evaluation, other than the ex ante criteria for tariff approval articulated by regulators (if any exist). In reviewing the appropriateness of a state action exception based on this regulatory approach, federal courts need to assess whether the rationales given at the time of state/local approval of state/local market-based rates are consistent with pre-articulated pro-competitive policies. If no such policies have

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energy cases to preclude lawsuits against companies based on rates that were filed with a government agency."). Even though Texas regulation was at issue, the Fifth Circuit cited exclusively to cases involving federal, not state, regulators. *See* Keogh v. Chicago & Northwestern Railway Co., 260 U.S. 156 (1922) (applying the filed rate doctrine as a defense in an antitrust case where the allegedly anticompetitive conduct was sanctioned by a tariff filed with the Interstate Commerce Commission); Square D Co. v. Niagara Frontier Tariff Bureau, Inc., 476 U.S. 409 (1986) (same). These filed rate cases invoke the filed rate doctrine based on the notion that *federal regulation* preempts state regulation or makes federal judicial assessment unnecessary; however, there was no federal regulation at issue in the case. The Fifth Circuit did not examine whether and how *state regulation* presents a conflict with the Sherman Act.

[250] For criticism of this Texas district court decision for emphasizing the wrong regulatory axis, see Jim Rossi, *Debilitating Doctrine: How the Filed-Rate Policy Wreaks Havoc—And What Courts Can Do About It*, PUBLIC UTILITIES FORTNIGHTLY, November 2004, at 16 (suggesting that the decision should have been decided under the state action exception – not the filed rate doctrine). Unfortunately, in hearing the appeal, the Fifth Circuit made precisely the same mistake – effectively endorsing a broad filed rate defense to deal with federal-state conflicts where the issue should have been addressed as a state action exception, which explicitly would pays attention to accountability in the state regulatory process. Interestingly, neither the district court opinion nor the Fifth Circuit addressed the state action exception.

been articulated, it is beyond the role of federal courts to provide them – nor should state and local regulators be allowed to provide such rationales in amicus briefs post hoc.

Perhaps the most challenging new issue in applications of the state action exception is disclosure and monitoring programs. Just as disclosure and monitoring programs are increasingly popular at the federal level, many state and local regulators have experimented with the same approach in traditional and new regulatory scenarios.[251] For example, energy suppliers in deregulated electric power markets are frequently required to register and file reports with regulators regarding their market activities. If a state requires the disclosure of information for purposes of market monitoring, the fundamental question in deciding whether to extend state action immunity hinges on the

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[251] In addition to states that continue to require reporting for traditional electric utilities using market-based rates, disclosure requirements for suppliers range from reporting information to regulators about pricing and information about generation, distribution, and transmission, to labeling laws that require the disclosure of fuel content. Many states also require registration and reporting for intermediate market actors, including aggregators, marketers, and brokers. For example, the Virginia registration summary is online at http://www.vaenergychoice.org/suppliers/suppliers.asp and a summary of many of these licensing requirements is online at http://www.distributed-generation.com/licensing.htm. For a more complete description of such requirements, see RICHARD P. SEDANO, ELECTRIC PRODUCT DISCLOSURE: A STATUS REPORT (National Council on Competition and the Electric Industry 2002), available at http://www.ncouncil.org/pdfs/disclosure_final.pdf. This is clearly a major shift in the role of state regulators in this industry, from traditional rate hearings to information gathering, monitoring, investigation and, at the extreme, whistle blowing or enforcement.. These examples from state electric power regulation are a small part of a larger emphasis on disclosure as a regulatory approach in this and other industries. *See* Charles Koch, *Collaborative Governance in the Restructured Electricity Industry*, 40 WAKE FOREST L. REV. 589, 610 (2005) (emphasizing the need for state regulators to transform themselves from traditional price regulators to "investigative/disclosure" vehicles and "ultimate monitors/whistleblowers"); Dana Brakman Reiser, *Enron.Org: Why Sarbanes-Oxley Will Not Ensure Comprehensive Nonprofit Accountability*, 38 U.C. DAVIS L. REV. 205, 239-40 (2004) (describing state attorney general registration and disclosure programs for nonprofit solicitation). *See also* Donald F. Santa, Jr.*, Who Needs What, and Why? Reporting and Disclosure Requirements in Emerging Competitive Electricity Markets,* 21 ENERGY L.J. 1 (2000) (describing a new class of disclosure requirements at the federal and state levels).

standards state officials apply in monitoring and deciding to enforce against firms that have disclosed information to regulators. For example, a group of private firms might disclose their participation in joint rate making activities. If the regulator did not act to prohibit the practice, the firms could claim antitrust immunity. At core, this type of problem challenges courts to examine state and local regulatory inaction, to decide if it is consistent with broader antitrust goals – paralleling calls that federal courts review agency inaction for arbitrariness at step two of *Chevron*.[252] To the extent a regulator's disclosure-and-monitoring standards are consistent with competition (i.e., pro-market, as is frequently the case with state plans designed to enhance competition), a federal court can review them for overlap with federal antitrust enforcement and should only extend a state action defense to the extent it is coextensive with the goals of the Sherman Act. If, on the other hand, a disclose-and-monitor program is inconsistent in its approach with the competitive goals of the Sherman Act, the fundamental inquiry should focus on whether a state/local agency gives reasons for failing to enforce that are consistent with its pre-articulated criteria to either displace competition or regulate it. If a state has no pre-articulated criteria, or if those criteria are only expressed ex post, a federal court should refuse to extend the state action exception.

CONCLUSION

In terms of remedy, under the delegation account advanced in this Article, a failure to apply the state action antitrust exception has less significant consequences than other judicial review of legislation or regulation. It does not result in condemning public

[252] *See* Bressman, *supra* note 145.

conduct or necessarily striking state or local legislation. It also does not require anything specific of state officials, other than the provision of reasons where state regulators wish to allow firms to escape antitrust scrutiny.[253] Nor does it result in vacation or reversal and remand, as may occur under *Chevron*. Instead, a failure to extend the state action exception merely subjects private conduct to judicial evaluation under the antitrust laws. Such an approach preserves federalism values by protecting the type of democratic participation that forms the core of federalism. It also reduces the incentive for private interest groups to quietly lobby state and local regulators in ways that allow state action doctrine to become a forum shopping strategy for private firms to opt out of antitrust enforcement.

While accountability-driven, this proposal is not intended to interpret the Sherman Act as a free-roaming invitation to federal judges to impose their own political accountability ideals onto state and local governments. First and foremost, the antitrust laws are about competition and efficiency in private markets. Often, however, industries face a mix of private and public ordering; the state action exception defines that mix where state or local regulation is at issue. Nothing in the history of the Sherman Act indicates that political accountability was its primary goal, but if the judicially-fashioned

[253] The Tenth Amendment does not pose a barrier to a process-based account of the state action antitrust exception, given that no state or local regulatory action is compelled and that it is democracy-promoting at the state and local level. *Printz v. United States* establishes clearly that Congress or federal regulators cannot "commandeer" state officials by requiring them to act. 521 U.S. 898 (1997). Under the delegation account of the state action exception presented in this Article, state officials may still choose not to articulate reasons and may refuse to file briefs in federal antitrust cases. Even if they do so, the state or local regulatory program still would survive under both federal and state law to the extent it is not inconsistent with federal antitrust law. However, if the approach proposed in this Article were adopted, the silence or inaction of state or local officials clearly would have consequences for private firms invoking the regulatory program as a basis for a state action exception from antitrust enforcement.

state action exception fails to heed accountability this could come at the cost of the explicit goals of competition law. While state or local governments have the choice to embrace monopoly over competition, Congress could not have intended to encourage private firms that wish to avoid federal antitrust scrutiny to hide behind the veil of state or local government approval without some transparency and accountability for public decisions, as this would allow state and local governments to facilitate antitrust violations with no scrutiny at all.[254] In addition, paying attention to political accountability advances at least one articulation of the primary goals of the antitrust laws: that Congress sought to protect competition by smaller firms for purposes of ensuring that large firms with monopoly power do not dominate the political process, especially at the state and local level, where powerful firms are more likely to thwart lawmaking that maps majoritarian preferences. In this sense, market competition may have been designed to encourage not just any private arrangement but those that are most consistent with increased political accountability.[255] The approach urged in this Article limits assessment of political accountability issues to antitrust defenses, promoting judicial economy and leaving adjudication of substantive offenses to focus on the other goals of antitrust law, such as promoting consumer welfare and substantive efficiency. Even if the more ambitious proposal of viewing the defense entirely through a process lens is not endorsed,

[254] This implication of broad state action immunity is discussed *supra* at Part I.
[255] *See* Elhauge, *supra* note 12 (proposing a process-based interpretation of antitrust law); Pitofsky, *supra* note 56 (urging a populist interpretation of the Sherman Act for political legitimacy reasons).

the Article has advanced the case for requiring attention to procedure as an evidentiary predicate to making a decision to extend the state action exception on other grounds.[256]

Casting state action issues as a type of vertical deference requiring reasons provides a way for federal courts to reconcile competition policy with state regulation without sacrificing political accountability at the state and local level or undermining the goals of antitrust law. If courts addressing state action exception issues were to draw on the delegation principles that inform *Chevron* and its application, antitrust law would be much better equipped to deal with the issues presented by inaction in state and local regulation, particularly as industries such as insurance, health care, energy and telecommunications are restructured to enhance competition.

[256] For example, the signaling function that is served by hard look review of state or local regulation could be help courts to evaluate whether a state sovereign sees the benefits of a regulatory program as justifying the costs. *See* Stephenson, *supra* note 147. Such an approach would aid courts in making decisions under Squire's preemption approach. *See supra* note 109 (describing how Squire incorporates process considerations into his substantive preemption analysis).

ABSTRACT

Courts struggle with the tension between national competition laws, on the one hand, and state and local regulation, on the other – especially as traditional governmental functions are privatized and as economic regulation advances beyond its traditional role to address market monitoring. This Article defends a process-based account of the state action antitrust exception against alternative interpretations, such as the substantive efficiency preemption approach recently advanced by Richard Squire, and elaborates on what such a process-based account would entail for courts addressing the role of state economic regulation as a defense in antitrust cases. It recasts the debate as focused around delegation issues and judicial deference to regulation – traditionally issues of administrative law. State action antitrust exception issues frequently are invoked where state officials fail to act or only act partially to regulate, as is increasingly common where states privatize governmental functions or attempt to deregulate, or implement competition policies of their own. As I shall argue, in such contexts a delegation model, which focuses on the conditions under which state legislative bodies have made delegations, whether agency regulators have standards, and the reasons provided by state and local officials for regulatory inaction, provides a more powerful and principled approach for evaluating the interaction between regulation and antitrust litigation than alternative approaches.

A process-based account of the state action exception recognizes federalism and efficiency as important values, but changes the primary emphasis of the judicial inquiry. Federalism values and economic efficiency may well be advanced by applications of the state action exception, but that does not require courts to ground their decisions in individual cases entirely on federal preemption legal analysis or on an assessment of the substantive efficiency of state or local regulation. On a process-based account, federalism goals could be advanced by state and local political processes as much as by federal courts attempting to identify and apply the substantive values in broad federal statutes such as the Sherman Act. Moreover, a process-based account of antitrust defenses, such as the state action exception, recognizes the possibility that economic efficiency can inform the application of the substantive standards of antitrust law without requiring economic efficiency to be the primary focus in evaluating every governmental program, particularly at the state and local level. By discouraging courts from directly addressing economic efficiency concerns before addressing the merits of an antitrust violation, such an approach promotes judicial economy and, if properly cabined, can also have a positive effect on the behavior of private groups in the lawmaking process. Even within alternative accounts that give priority to federalism or economic efficiency, the delegation approach should be used to inform the evidentiary assessment of procedure, serving as predicate any judicial decision to extend a state action antitrust exception.

The Article proceeds in four parts. Part I discusses the problems with current formulations and applications of the antitrust state action exception, which no one finds satisfactory. As I argue, traditional approaches, such as a federal preemption-oriented understanding of state action doctrine, have serious limitations given a state and local regulatory environment that is increasingly characterized by regulatory transition and

inaction. Part II introduces *Chevron*, the predominant paradigm for judicial review of regulation in administrative law, highlighting its delegation structure and aspects of it that are useful to understanding the problems state regulation present for antitrust law. Part III explains limits to the analogy between *Chevron* step one and the clear articulation requirement for antitrust state action. Part IV draws an analogy to step two of *Chevron* and analyzes the implications of recasting the state action antitrust exception to focus on agency reasons, not power or history. The Article concludes by addressing the kinds of reasons that should suffice for purposes of addressing active regulatory supervision at the state and local level as a predicate to extending an antitrust state action exception.