



ANTITRUST AND THE SUPREMACY CLAUSE

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In the course of damning the market giant Standard Oil, the Supreme Court declared that the purpose of the Sherman Antitrust Act is to prevent “monopoly and the acts which produce the same result as monopoly.” The Constitution’s Supremacy Clause, in turn, requires preemption—that is, non-enforcement—of state laws that conflict with a federal statute. Put together, these propositions suggest that state laws which create monopolies should be prime candidates for preemption via the Sherman Act. But despite the syllogistic logic bearing down on them, monopoly-creating state laws have easily weathered most federal antitrust challenges, even when the state does not regulate the price the monopolist charges. The reason is that the Supreme Court’s antitrust decisions on state economic regulation have consistently confused two distinct questions: whether market conduct encouraged by state law violates the Sherman Act, and whether state law conflicts with the Sherman Act and thus is preempted. This confusion explains other problems in the Court’s antitrust jurisprudence, including the Court’s inability to make sense of antitrust claims against municipalities acting as lawmakers rather than market participants. In this Article, I describe the sources and consequences of the Court’s confusion, and then I propose how to resolve it.

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* Associate Professor, Fordham University School of Law. Robert Jackson provided thorough and highly insightful editorial suggestions. I am also indebted to the following individuals for their useful comments: Bob Bone, Daniel Crane, Henry Hansmann, Keith Hylton, Jameson Jones, John McGinnis, Mike Meurer, and Mark Patterson.

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INTRODUCTION

To decide if a federal statute blocks enforcement of a state law, the Supreme Court normally asks whether the state law conflicts with the purpose of the federal statute and thus is preempted under the Supremacy Clause. But in cases of conflict between state economic regulation and the Sherman Antitrust Act, the Court has eschewed its standard preemption approach. Instead, the Court applies its doctrine of “state-action immunity,” under which a state regulation is unenforceable only if it arises from or causes a “violation” of the same federal antitrust rules that restrict the market conduct of private firms.

The Court’s “violation” requirement is ill-suited to preemption questions because the antitrust rules for market participants rest on assumptions that do not apply to trade restraints imposed instead by lawmakers. For example, although a primary objective of the Sherman Act is to prevent firms from acquiring unchecked monopoly power, courts do not deem mere possession of monopoly an antitrust violation. The reason is that firms in otherwise competitive markets often acquire temporary monopoly power through innovation that benefits consumers. Monopolies protected by state economic regulation, by contrast, rarely reward innovation, and by definition are shielded from the market forces that make most monopolies temporary. But because of the violation requirement, courts have repeatedly dismissed federal antitrust challenges to state laws creating monopolies, even if the state does not regulate the price the monopolist charges. In this way, the violation requirement causes courts to excuse state schemes that involve no illegal market conduct but nonetheless clash with federal antitrust policy.

The violation requirement stems from the Court’s broader failure in its state-action immunity cases to ask whether the enforceability of federal or state law is at stake. In a challenge to the enforcement of federal antitrust law the question of an antitrust violation is pertinent: such a challenge begins when a market participant is (or fears being) accused of violating the Sherman Act, and that party defends on grounds that the Act contains an implicit exemption for conduct which furthers a valid state regulatory scheme. But if a market participant instead invokes the Sherman Act to challenge enforcement of state law, an alleged *state* law violation is the source of the controversy, and the only federal question is whether the state law conflicts with the purpose of the Act and therefore is preempted. In that case the question whether there has been

market conduct that violates federal antitrust law is usually irrelevant and often misleading, as challenges to state laws protecting monopolies illustrate.

The Court's confusion of violation and preemption also explains why the Court's antitrust decisions involving municipalities have been especially controversial. Municipalities can act as market participants and thus sometimes violate the Sherman Act, and they also can enact economic regulation that conflicts with the Act. But the Court has overlooked this fundamental distinction; indeed, in one case it suggested that a municipality violated the Sherman Act—and therefore was subject to triple damages—merely for enacting regulation that reduced economic competition, as of course most regulation does. That decision forced Congress to immunize municipalities against all antitrust claims for damages. Despite this congressional rebuke, the Court has continued to conflate the distinct questions of antitrust violation and preemption, thereby revealing that it has yet to identify the root of its troubles in its state-action immunity jurisprudence.

In this Article I show how the Supreme Court, by running together questions of antitrust violation and preemption, has failed to identify conflict between state economic regulation and federal antitrust policy. In particular, I show how the Court's state-action immunity doctrine, while useful for determining whether otherwise illegal market conduct advances a state regime, does not reveal whether a state regime should be deemed preempted. I thus derive rules of antitrust preemption to replace that doctrine when the question is the enforceability of state rather than federal law. Unlike the Court's violation requirement, my approach vindicates the Supremacy Clause because it identifies those state laws that clash with Congress's objective to prevent marketplace wealth transfers from consumers to producers. My approach also recognizes that Congress intended lawmakers to enjoy greater latitude than private firms to restrain trade. This fact plus differences in incentives suggests that state lawmakers unlike private firms should be able to harm consumers in order to enrich non-producers or impose "fair" prices. My approach is therefore deferential when an economic goal other than producer enrichment is evident on the face of a state regulatory scheme. But when a state suspends price competition among producers and thereby creates a monopoly or the equivalent of a cartel, the high degree of conflict with federal antitrust policy weighs in favor of preemption.

Disentangling questions of antitrust violation and preemption also clears up another confusing aspect of current doctrine. The Supreme Court has held that a party who seeks state-action immunity must show that public officials "actively supervise" private market participants. When a party seeks relief from enforcement of the Sherman Act, such supervision is useful evidence that the state intended the party's conduct. But when a party instead seeks relief from enforcement of state law, the Court has been unable to explain why active supervision should matter, a problem obscured by the Court's general failure to

break out antitrust preemption as a distinct category of claim. I observe that 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 antitrust policy. My proposed preemption doctrine therefore allows states to suspend price competition among producers if the state also steps in to set market prices.

I. VIOLATION AND PREEMPTION RUN TOGETHER: ANTITRUST CONFLICT UP TO NOW

The Sherman Act makes it a federal crime for a person engaged in interstate commerce to make an agreement "in restraint of trade" or to "monopolize."¹ When the Act was passed in 1890, the only meaning of "monopoly" at common law was an exclusive trading position granted or held by a government.² During the Act's first fifty years, however, courts had little occasion to consider the Act's impact on state-created monopolies and other state (and local³) regulatory schemes.⁴ But beginning in the 1930s, the Supreme Court broadened its definition of interstate commerce and, by implication, the set of economic activities within the Sherman Act's reach.⁵ Antitrust's second half-century therefore saw more than a dozen cases in which the Court sought to resolve alleged conflict between the Sherman Act and state economic regulation. The Court decided most of these cases by applying its "state-action immunity" doctrine, also called the *Parker* doctrine for its genesis in the 1943 case *Parker v. Brown*.⁶ Beginning with *Parker*, the Court has

1. Sherman Antitrust Act, 15 U.S.C. § 1 (2006) ("Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal."); *id.* § 2 ("Every person who shall monopolize, or attempt to monopolize . . . any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony . . .").

2. PHILLIP AREEDA ET AL., ANTITRUST ANALYSIS: PROBLEMS, TEXT, AND CASES ¶ 130, at 36 (6th ed. 2004).

3. Unless I specify otherwise, I use the term "state law" to mean all laws that issue from a state's lawmaking authority, regardless of whether enacted by a state legislature, a rule-making agency, or a political subdivision such as a municipality. All such laws enjoy equal weight for Supremacy Clause purposes. *Id.* ¶ 164, at 128.

4. The two notable exceptions are *Northern Securities Co. v. United States*, 193 U.S. 197, 338 (1904) (holding that the legality of a merger under state law did not immunize the merging parties from prosecution under the Sherman Act), and *Olsen v. Smith*, 195 U.S. 332, 344-45 (1904) (holding that the Act did not preempt a state scheme to regulate pilotage services in an international seaport).

5. See 1 PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW: AN ANALYSIS OF ANTITRUST PRINCIPLES AND THEIR APPLICATION ¶ 216a (2005).

6. 317 U.S. 341 (1943).

consistently confused the distinct questions whether the Act prohibits market conduct and whether it preempts state law. While the doctrine formed by *Parker* and its progeny has attracted extensive criticism—including a congressional rebuke—neither the Supreme Court nor previous commentators have recognized how that doctrine’s multiple deficiencies stem from this single point of confusion.

A. *Parker’s Invisible Preemption Doctrine*

Parker was a preemption case: the only question in it was whether federal law rendered a state regulatory regime unenforceable. But one could easily read the Court’s opinion without noticing.⁷ California had created a scheme in which state officials enriched raisin farmers by restricting raisin sales and thereby raising prices.⁸ Farmer Brown, fearing fines or imprisonment under California law if he honored sales contracts signed before the scheme took effect, sued state officials to block the scheme’s enforcement.⁹ Although federal law allows private parties such as Brown to sue for triple damages if they are injured by conduct the Sherman Act prohibits,¹⁰ Brown did not allege that California or its officials had violated the Act. Instead, *Parker* sought injunctive relief on grounds that the raisin regime was unenforceable under the dormant commerce clause.¹¹ On appeal, the Supreme Court also asked for briefing on “whether the state statute involved is rendered invalid by the action of Congress in passing the Sherman Act.”¹² A congressional statute renders a state law invalid by operation of the Supremacy Clause;¹³ the Court was thus asking a preemption question.

When the Court issued its opinion, however, it failed to mention the Supremacy Clause or any form of the term “preemption.” Instead, the Court reasoned as follows: the raisin regime surely “would violate the Sherman Act” if achieved by a “conspiracy of private persons.”¹⁴ But the regime instead arose from “the legislative command of the state,”¹⁵ and nothing in the Sherman

7. Cf. 1 AREEDA & HOVENKAMP, *supra* note 5, ¶ 217d (“*Parker* was necessarily, although perhaps implicitly, a holding that the state statute was consistent with the federal statute and therefore was not preempted by it.”) (emphasis in original).

8. *Parker*, 317 U.S. at 347-48.

9. *Id.* at 348-49.

10. Clayton Act § 4, 15 U.S.C. § 15(a) (2006).

11. *See Cantor v. Detroit Edison Co.*, 428 U.S. 579, 586 (1976) (reviewing *Parker’s* procedural history).

12. *Id.* at 587 n.16.

13. “This Constitution, and the Laws of the United States which shall be made in Pursuance thereof . . . shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.” U.S. CONST. art. VI, cl. 2.

14. *Parker*, 317 U.S. at 350.

15. *Id.*

Act's text or history suggested a congressional purpose "to restrain a state or its officers or agents from activities directed by its legislature."¹⁶ The Court thus concluded: "The state . . . made no contract or agreement and entered into no conspiracy in restraint of trade or to establish monopoly but, as sovereign, imposed the [raisin regime] as an act of government which the Sherman Act did not undertake to prohibit."¹⁷ In other words, the Court rejected Brown's preemption claim on a finding that the "sovereign" acts of creating and enforcing a regulatory scheme do not constitute the forms of conduct the Act prohibits.

The notion, however, that a state law is preempted only if the state in enacting or enforcing the law committed a federal offense is a constitutional non sequitur. And the *Parker* Court surely knew this: just two years earlier, the Court had held in *Hines v. Davidowitz* that the federal Alien Registration Act preempted a state immigrant-registration scheme even though nothing in the federal statute made it an offense for state officials (or anyone else) to register immigrants.¹⁸ Hardly an outlier, *Davidowitz* is cited today as the source of the textbook preemption standard whereby a state law is unenforceable if it "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress."¹⁹ But the Court in *Parker* ignored *Davidowitz* and the preemption standard it articulated, focusing solely on the legality of California's conduct.²⁰ The unavoidable impression is that the *Parker* Court had confused Brown's preemption claim for the separate claim, not present in the case, that California officials had violated the Act and therefore might be subject to damages or other statutory penalties.²¹

16. *Id.* at 350-51.

17. *Id.* at 352.

18. *Hines v. Davidowitz*, 312 U.S. 52, 60-61 (1941). The Alien Registration Act did contain a criminal provision—but only for aliens who failed to register, *not* for individuals who tried to register them. *Id.*; see also S. Paul Posner, *The Proper Relationship Between State Regulation and the Federal Antitrust Laws*, 49 N.Y.U. L. REV. 693, 702-03 (1974) (citing several post-*Parker* decisions in which the Court found preemption without a technical statutory violation).

19. See KATHLEEN M. SULLIVAN & GERALD GUNTHER, CONSTITUTIONAL LAW 329-30 (15th ed. 2004) (quoting *Davidowitz*, 312 U.S. at 67).

20. The closest the Court came to addressing preemption was in noting that Congress probably could have forbidden the California regime under the Commerce Clause had it wanted, and that Congress could occupy a "legislative field" through its "constitutional power to suspend state laws." *Parker*, 317 U.S. at 350. But the Court moved from these generalities directly to its finding that the raisin regime did not entail a federal offense. *Id.* Thus, an alternative (though hardly more flattering) interpretation of *Parker* is that the Court had, in the language of constitutional scholars, considered "express" and "field" preemption, but somehow had forgotten about "conflict" preemption—even though it had just found conflict preemption under a different statute in *Davidowitz*. See generally SULLIVAN & GUNTHER, *supra* note 19, at 329-30 (explaining the types of preemption).

21. Principles of sovereign and qualified immunity might have protected California officials from criminal sanctions and civil damages, thus limiting Brown only to prospective

A disagreement among the Justices in the later antitrust case *Cantor* confirms the confused nature of the *Parker* opinion. The *Cantor* plurality read the *Parker* holding to be that “action taken by state officials . . . did not violate the Sherman Act.”²² But three Justices disagreed, pointing out that “the precise issue on which the Court sought reargument was whether the California statute was pre-empted by the Sherman Act”²³ Alas, both sides in *Cantor* were right: the issue in *Parker* was preemption, but the Court had irrelevantly held that state officers had not committed a Sherman Act violation.

Instead, however, of correcting *Parker*’s confusion of violation and preemption, the Court’s subsequent antitrust preemption decisions formalized it. A run of six *Parker*-line decisions (including *Cantor*) in six years culminated in the 1980 case *Midcal*,²⁴ where the Court articulated the state-action immunity doctrine in its current form. *Midcal* was a challenge to the enforcement of a state regime that forbade wine wholesalers from charging prices lower than those posted on public schedules by wine producers.²⁵ Although the case presented only a preemption question, the Court, as it had in *Parker*, mentioned neither preemption nor the Supremacy Clause, and instead characterized the “threshold question” to be whether the state regime “violates” federal antitrust law.²⁶ The Court then held that the state scheme did constitute such a “violation” because it involved “resale price maintenance,”²⁷ a term referring to an effort by a seller to control prices charged by downstream resellers. But to be a Sherman Act violation, such conduct by the wine producers in *Midcal* would have had to run afoul of the Act’s section 1,²⁸ which requires an agreement.²⁹ And no agreement existed: the very purpose of

relief even on a violation claim. Prospective relief is also the only form available on a preemption claim, which might have contributed to the Court’s confusion. But the fact that findings of violation and preemption might yield the same remedies does not mean they raise the same legal questions.

22. *Cantor v. Detroit Edison Co.*, 428 U.S. 579, 589 (1976) (Stevens, J.).

23. *Id.* at 618 (Stewart, J., dissenting).

24. *Cal. Retail Liquor Dealers Ass’n v. Midcal Aluminum, Inc.*, 445 U.S. 97 (1980). The other five cases in the six-year *Parker* spree were *Goldfarb v. Virginia State Bar*, 421 U.S. 773 (1975); *Cantor*, 428 U.S. 579; *Bates v. State Bar of Arizona*, 433 U.S. 350 (1977); *City of Lafayette v. Louisiana Power & Light Co.*, 435 U.S. 389 (1978); and *New Motor Vehicle Board v. Orrin W. Fox Co.*, 439 U.S. 96 (1978).

25. *Midcal*, 445 U.S. at 100.

26. *Id.* at 102.

27. *Id.* at 103.

28. Sherman Antitrust Act § 1, 15 U.S.C. § 1 (2006).

29. In *United States v. Colgate & Co.*, 250 U.S. 300 (1919), the Court held that section 1 of the Act does not prohibit efforts by a firm to impose resale prices unilaterally (which is what the *Midcal* regime entailed) by, for example, cutting off resellers who do not adhere to suggested price schedules. *Id.* at 307. The Court in *Midcal* made no attempt to distinguish *Colgate*.

the scheme was to empower producers to impose price floors at the wholesale level without the wholesalers' consent.

Midcal thus compounded *Parker*'s error: not only did the Supreme Court mischaracterize a preemption question as a violation question, but it then misstated whether a violation had in fact occurred. In this way the case illustrates the contortions that preemption analysis must suffer to be shoehorned into the elements of a violation claim. Importantly, *Midcal* is not alone in this regard: the Court has struck down state laws in two other state-action immunity cases, and neither of those—*Schwegmann v. Calvert Distillers Corp.*, and *324 Liquor Corp. v. Duffy*—involved an actual antitrust violation either.³⁰ But the Court did not acknowledge this, lapsing both times into the *Midcal* fiction that illegal conduct had in fact occurred.³¹

Midcal is best known not for its threshold violation requirement, but rather for establishing that a state law entailing a violation can nonetheless qualify for “immunity” if it satisfies two requirements.³² Under the first, known as the “clear articulation” requirement, “the challenged restraint must be one clearly articulated and affirmatively expressed as state policy.”³³ And under the second, the “active supervision” requirement, “the policy must be actively supervised by the state itself.”³⁴ The Court held that the state regime in *Midcal* failed the active supervision requirement because “[t]he State neither

30. *Duffy* was like *Midcal* in that it involved a state regime whereby one firm could impose minimum resale prices on another by posting a price schedule. *324 Liquor Corp. v. Duffy*, 479 U.S. 335, 337-40 (1987). *Duffy* thus involved no price-fixing agreement and hence, like *Midcal*, no Sherman Act violation. The regime in *Schwegmann* was a little more complicated, entailing state-approved price-fixing contracts between liquor distributors and retailers. *Schwegmann Brothers v. Calvert Distillers Corp.*, 341 U.S. 384, 385-86 (1951). Although such contracts would normally have violated the Sherman Act, Congress in 1937 had passed amendments that permitted states to authorize such agreements in the liquor industry. *Id.* at 386. But the state statute at issue in *Schwegmann* also contained a “nonsigner provision,” not explicitly authorized by Congress, under which the minimum prices specified in an agreement with one retailer bound all other retailers who sold the same commodity. *Id.* at 387. It was this nonsigner provision, which entailed no conduct in violation of the Sherman Act, that the Court deemed invalid. *Id.* at 389; *see also* Rice v. Norman Williams Co., 458 U.S. 654, 666-67 (1982) (Stevens, J., concurring) (noting that the parties in *Schwegmann* had not engaged in conduct the Sherman Act prohibits); Posner, *supra* note 18, at 700-01 (same); John E. Lopatka & William H. Page, *State Action and the Meaning of Agreement Under the Sherman Act: An Approach to Hybrid Restraints*, 20 YALE J. ON REG. 269, 294-97 (2003) (noting that none of *Schwegmann*, *Midcal*, and *Duffy* involved conduct that would satisfy the agreement element of the Act's section 1).

31. *See Duffy*, 479 U.S. at 342 (finding an “antitrust violation [which] is essentially similar to the violation in *Midcal*”); *Schwegmann*, 341 U.S. at 385-86 (asserting that the private firms against whom a preemption claim was pled had engaged in “price fixing” that was “illegal per se” and could subject the firms to “civil and criminal penalties”).

32. *Midcal*, 445 U.S. at 105.

33. *Id.* (internal quotation marks omitted).

34. *Id.* (internal quotation marks omitted).

establishes prices nor reviews the reasonableness of the price schedules.”³⁵ To explain why this lack of supervision mattered, the Court offered only a metaphor, describing the state regime as “a gauzy cloak of state involvement [cast] over what is essentially a private-fixing agreement.”³⁶ But this “gauzy cloak” image is itself obscure: it is hard to see how the imposition of a price on a party without that party’s consent is “essentially” an “agreement,” and to call the arrangement “essentially . . . private” reiterates the lack of state supervision but does not say why it is important. More generally, the Court’s metaphor depicts a state trying to cover up conduct that violates federal law, and thus forgets that one of those would-be violators brought the action for fear of prosecution under *state* law. Unfortunately, the Court’s *Parker*-line decisions since *Midcal* have done no better explaining the function of active supervision in the preemption context.

Parker and *Midcal* reflect the Court’s more common approach in antitrust preemption cases, which is to omit reference to preemption altogether. In a few instances, however, the Court has made the fact that it is deciding an antitrust preemption claim explicit. But even in these cases the Court has held that a state regime is preempted only if it causes an antitrust violation—thereby replicating the analytic confusion found in *Parker* and *Midcal*. The most recent example is *Rice v. Norman Williams Co.*, involving a challenge to the enforceability of a state regime that enabled liquor distillers to designate which wholesalers within the state enjoyed the exclusive right to import the distillers’ products.³⁷ This time the Court announced that it was deciding a preemption claim—but nonetheless deemed the regime valid because it did not encourage “conduct that necessarily constitutes a violation of the antitrust laws in all cases.”³⁸

B. *The Parker Line’s Implied Exemption Cases*

Making the Court’s confusion of preemption and violation all the more pernicious is the fact that the Court also applies its state-action immunity doctrine in cases which, unlike *Parker* and *Midcal*, really do involve an allegation that someone has violated the Sherman Act. An example is *Motor Carriers*, in which the Department of Justice accused truckers of horizontal

35. *Id.*

36. *Id.* at 98.

37. 458 U.S. 654, 656-57 (1982).

38. *Id.* at 661; accord *Joseph E. Seagram & Sons, Inc. v. Hostetter*, 384 U.S. 35, 45 (1966) (rejecting an antitrust preemption challenge to a state regime, which forbade liquor brand owners from charging prices within the state higher than they had charged elsewhere, on grounds that the allegedly anticompetitive conduct required of the brand owners—the compilation of competitive price information—was not a Sherman Act violation), *overruled on other grounds*, *Healy v. Beer Inst.*, 491 U.S. 324, 343 (1989).

price-fixing, which violates the Act's section 1.³⁹ The truckers admitted that they had worked together on rate proposals which they had then submitted to state rate-making commissions, but they defended on grounds that their collaboration had been encouraged by the commissioners, who allegedly found joint proposals easier to evaluate.⁴⁰ The Court announced that the only difference between the case and *Midcal* was that *Midcal* arose from a claim against a state agency while *Motor Carriers* involved claims against private parties.⁴¹ The Court then deemed this to be a distinction without a difference, and held that the truckers qualified for "*Parker* immunity" because they could satisfy the clear articulation and active supervision requirements established in *Midcal*.⁴²

The Court was surely correct that the private status of the *Motor Carriers* defendants was irrelevant. A public entity—such as a municipality—can also engage in market conduct, and when it does it can be sued for conduct the Sherman Act prohibits.⁴³ But by focusing on the private status of the *Motor Carriers* defendants, the Court missed the real difference with *Midcal*. In *Midcal*, a party who feared prosecution under state law claimed that the Sherman Act rendered the state law unenforceable. The *Motor Carriers* defendants made the opposite claim: that state law rendered their conduct exempt from prosecution under the Sherman Act.

At first blush, the notion that state law can halt enforcement of a federal statute gets the Constitution exactly backwards. But *Motor Carriers* reflects a plausible reading of congressional intent if the state regulatory schemes were valid and the conduct that allegedly violated the Sherman Act made the schemes cheaper to administer. To deter the defendants' otherwise illegal conduct in that case would have inconvenienced the states while serving no obvious federal purpose, a result that Congress in enacting the Sherman Act presumably did not wish.

Motor Carriers can thus be classified as an "implied exemption" case, as contrasted with *Parker* and *Midcal*, which were preemption cases. To be sure, an implied exemption claim can raise a preemption question: the justification for an exemption would disappear if the state regime in which the defendant sought refuge were itself in conflict with the Sherman Act. But this does not mean that preemption and implied exemption questions are the same: the *Midcal* regime was preempted even though it entailed no Sherman Act

39. *S. Motor Carriers Rate Conference, Inc. v. United States*, 471 U.S. 48, 50 (1985).

40. *Id.* at 50-51.

41. *Id.* at 57, 61.

42. *Id.* at 65-66.

43. *See, e.g., City of Lafayette v. La. Power & Light Co.*, 435 U.S. 389, 398 (1978) (holding that a municipality can be subject to penalty for violating the Sherman Act); *Goldfarb v. Va. State Bar*, 421 U.S. 773, 791-92 (1975) (permitting a Sherman Act claim to proceed against a state bar association).

violations and thus could not have given rise to an implied exemption claim. Conversely, even if a state regulatory regime is not preempted, an implied exemption would be unwarranted if the defendant could not show that the defendant's conduct made that regime cheaper to administer. But despite these differences, the Supreme Court has failed to distinguish preemption and implied exemption questions in its state-action immunity jurisprudence, and has applied the same doctrinal elements to both.⁴⁴

Because the Court tends to confuse preemption claims for violation claims, the elements of its state-action immunity doctrine fit implied exemption questions better than preemption questions. I have already noted how *none* of the state regimes the Court has deemed unenforceable under its state-action immunity doctrine involved an actual antitrust violation. Furthermore, the clear articulation requirement is at best redundant to preemption analysis: the state regime that the claimant must identify is obviously whichever one the claimant wants declared unenforceable. Finally, while the active supervision requirement seems to serve a function in preemption decisions such as *Midcal*, the Court has been unable to give a coherent account of it. By contrast, all of these elements serve manifest purposes in implied exemption cases. By definition, an implied exemption claim arises only if someone has been (or fears being) accused of violating federal antitrust law. The clear articulation requirement then forces the defendant to identify a state regulatory scheme the defendant's allegedly illegal conduct advanced. Finally, active supervision demonstrates that the defendant's conduct really was connected to the state regime and not just a frolic of the defendant's own. Or, as the Court aptly explained in the implied exemption case *Patrick v. Burget*, active supervision limits exemptions to those "particular anticompetitive acts of private parties that, in the judgment of the State, actually further state regulatory policies."⁴⁵

The Court would likely have avoided the major difficulties in its *Parker* jurisprudence had it applied its state-action immunity doctrine only to implied exemption questions—that is, to questions whether conduct that allegedly violates the Sherman Act advanced the objectives of a state regulatory scheme. But the Court has applied the doctrine to preemption questions as well, and therefore has gotten into trouble—most conspicuously (though not exclusively)

44. The pre-*Motor Carriers* implied exemption cases were *Northern Securities Co. v. United States*, 193 U.S. 197, 338 (1904) (exemption denied); *Goldfarb*, 421 U.S. 773 (exemption denied); *Cantor v. Detroit Edison Co.*, 428 U.S. 579, 589 (1976) (exemption denied); and *City of Lafayette*, 435 U.S. 389 (exemption granted). Besides *Parker*, the pre-*Midcal* preemption cases included *Olsen v. Smith*, 195 U.S. 332, 344-45 (1904) (preemption claim rejected); *Schwegmann Bros. v. Calvert Distillers Corp.*, 341 U.S. 384 (1951) (preemption affirmed); *Joseph E. Seagram & Sons, Inc. v. Hostetter*, 384 U.S. 35 (1966) (preemption rejected); *Bates v. State Bar of Arizona*, 433 U.S. 350, 368-69 (1977) (preemption rejected); and *New Motor Vehicle Board v. Orrin W. Fox Co.*, 439 U.S. 96 (1978) (preemption rejected).

45. 486 U.S. 94, 101 (1988).

in its decisions involving municipalities. This is not surprising: municipalities act both as market participants and as lawmakers, and so cases involving them—as I indicate next—are particularly likely to showcase the hazards of the Court’s failure to distinguish questions of violation and preemption.

C. “Violation” as the Source of the Court’s Municipality Mishaps

The Supreme Court first addressed an antitrust claim against a municipality in an implied exemption case; predictably, the Court reached a sensible result. The case was *City of Lafayette*, in which two Louisiana municipalities that generated and sold electricity were accused by a private competitor of entering into contracts in violation of the Act’s section 1.⁴⁶ The municipalities asserted that they were categorically immune from prosecution under the Sherman Act, but the Supreme Court rejected this,⁴⁷ citing previous decisions establishing that a state entity is a “person” under the Act and therefore punishable for conduct the Act forbids.⁴⁸ More modestly, the municipalities also argued that they were eligible for implied exemptions under the state-action immunity doctrine, and this time the Court agreed.⁴⁹ A plurality, moreover, took the parallel between municipal and private market conduct to its logical conclusion, holding that a municipal implied exemption requires showings of clear articulation and active supervision,⁵⁰ the same requirements the Court would later apply to private defendants in *Motor Carriers*.⁵¹

City of Lafayette’s clean logic jumped its rails, however, when the Court tried to apply it to a municipality acting as lawmaker rather than market participant. The case was *City of Boulder*, in which a private cable television company accused a municipality of violating the Act’s section 1 by enacting an ordinance that impeded the company’s expansion strategy.⁵² The city was not in the cable television business, and it had imposed the regulation ostensibly to keep the local market competitive.⁵³ But the cable company alleged a conspiracy between the city and one of the company’s rivals, a claim for which the district court found no evidence.⁵⁴ That finding should have ended the company’s violation claim: section 1, as I have noted, requires an agreement. But the district court instead obscurely held that the city remained “subject to

46. *City of Lafayette*, 435 U.S. at 392 n.6.

47. *Id.* at 408.

48. *Id.* at 395; *see also Goldfarb*, 421 U.S. at 791-92 (holding that the Act applies to state bar associations).

49. *City of Lafayette*, 435 U.S. at 413.

50. *Id.* at 410 (Brennan, J., plurality opinion).

51. *S. Motor Carriers Rate Conference, Inc. v. United States*, 471 U.S. 48, 50 (1985).

52. *Cmty. Commc’ns Co. v. City of Boulder*, 455 U.S. 40, 45-47 (1982).

53. *Id.*

54. *Cmty. Commc’ns Co. v. City of Boulder*, 485 F. Supp. 1035, 1038 (1980).

antitrust liability” for seeking “to influence competition” in the cable television market.⁵⁵ On certiorari, the Supreme Court chose only to decide whether, assuming a section 1 violation, the city’s conduct qualified under *City of Lafayette* for an implied exemption.⁵⁶ The Court then ruled that the city could not meet the clear articulation requirement. The only state regulatory scheme to which the city could point was the state constitution’s “home rule” amendment, which granted municipalities full powers of self-government.⁵⁷ But the Court held that this amendment did not constitute a specific state plan to authorize non-competitive conduct in the cable television market.⁵⁸ The Court therefore sent the case back for the district court to decide the cable company’s underlying violation claim.⁵⁹

If the city had in fact engaged in market conduct that potentially violated the Sherman Act, there would have been some logic to the *City of Boulder* holding. As I have noted, an implied exemption makes sense if there is a valid state regulatory scheme that the defendant’s otherwise illegal conduct made cheaper to administer. Exemptions would become the norm, however, if a “home rule” amendment counted as a state regulatory scheme: such an amendment is nothing more than authorization for a municipality to do whatever it wishes.

But the problem with *City of Boulder* was that the city council plainly had not violated the Sherman Act: it had neither sought a monopoly nor, as the district court had found, made an agreement with anyone. While the district court had observed that the city ordinance restricted the cable company’s ability to compete, this was—as then-Justice Rehnquist argued in dissent—evidence not of a violation of the Act, but at most that the ordinance might conflict with the Act and thus be preempted.⁶⁰ In other words, the city’s bid for an exemption was irrelevant because there was no potential violation that an exemption might cure. But the Court nonetheless decided the implied

55. *Id.* at 1038-39.

56. *City of Boulder*, 455 U.S. at 52.

57. *Id.* at 43 n.1.

58. *Id.* at 53.

59. *Id.* at 57.

60. *Id.* at 64-65 (Rehnquist, J., dissenting). Although Justice Rehnquist saw that the real issue in the case was preemption, he failed to understand that his disagreement with the majority arose because the Court had been trying to decide both preemption and implied exemption claims under a single doctrine. For example, he criticized the majority’s use of the term “exemption,” which he argued refers to a conflict between laws issued by the same sovereign. *Id.* at 61. But that missed the point: the majority used the term to refer to the type of implied exemption, recognized in *City of Lafayette* and later in *Motor Carriers*, that protects actions of market participants in furtherance of a valid state regulatory scheme. Also, when writing for the Court in *Rice*, a case decided only six months after *City of Boulder*, Justice Rehnquist held that a state law is preempted only if it encourages conduct that violates the Sherman Act. 458 U.S. at 659. This holding thereby perpetuated the confusion of preemption and violation displayed by the *City of Boulder* majority.

exemption question, thereby suggesting that it was not moot and that liability was possible. This was the preemption-violation confusion with fangs, opening cities to criminal fines and triple damages merely for enacting ordinances that regulate local economies, as of course many ordinances do. What is all the more remarkable is that in *Parker* the Court had issued the (reasonable, though in *Parker* extraneous) holding that the mere acts of enacting and enforcing law are not Sherman Act violations.⁶¹ But, again confirming the obscure nature of the *Parker* opinion, the Court in *City of Boulder* overlooked this.

City of Boulder raised predictable alarm among town officials nationwide.⁶² Congress responded with the Local Government Antitrust Act of 1984, which immunizes local governments against antitrust claims for damages.⁶³ This statute ended the nightmare scenario of triple damages for the mere act of legislating. But it preserved the possibility of antitrust claims against municipalities for injunctive relief, the standard remedy for a successful preemption challenge.

Congress's rebuke harvested judicial contrition, for immediately after passage of the Local Government Antitrust Act the Supreme Court handed down two antitrust decisions granting municipal petitions for relief.⁶⁴ Still not realizing, however, that the problem with *City of Boulder* was the failure to differentiate preemption and violation, the Court by backpedaling only stirred further confusion into the mix.

61. Some lower courts have focused on the Supreme Court's statement in *Parker* that California in creating the raisin regime was acting "as sovereign," *Parker v. Brown*, 317 U.S. 341, 352 (1943), and have read into this statement a distinction between laws issued by state legislatures and those issued by municipalities. *See, e.g., Elec. Inspectors, Inc. v. N.Y. Bd. of Fire Underwriters*, 145 F. Supp. 2d 271, 277 (E.D.N.Y. 2001) (interpreting *Parker* to mean that "municipalities do not enjoy the same deference due a state as sovereign"). But the notion that municipalities are not "sovereign" comes from the doctrine of sovereign immunity, which bars certain claims for damages that would be paid out of a state treasury. *See Mount Healthy City Sch. Dist. Bd. of Educ. v. Doyle*, 429 U.S. 274, 280-81 (1977); *Lincoln County v. Luning*, 133 U.S. 529, 530 (1890). It has nothing to do with preemption, for which the only relief is injunctive or declaratory, and state and local law enjoy equal status. Moreover, the Court in *Parker* did not use "sovereign" to suggest that a state as contrasted with a municipality is categorically immune from antitrust suit, for then the Court would have had no reason to emphasize simultaneously that California had "made no contract or agreement and entered into no conspiracy in restraint of trade or to establish a monopoly." *Parker*, 317 U.S. at 352. Rather, the Court used "sovereign" to distinguish the state as lawmaker from the state as market participant, and to establish that only when acting as market participant can the state commit a Sherman Act violation. The Court was holding, in other words, that the "sovereign" acts of passing and enforcing regulation do not violate the Act—a holding that, though irrelevant to the preemption claim actually at issue in *Parker*, nonetheless seems correct, and applies equally to municipalities.

62. *See* John E. Lopatka, *State Action and Municipal Antitrust Immunity: An Economic Approach*, 53 *FORDHAM L. REV.* 23 (1984).

63. 15 U.S.C. §§ 35-36 (2006).

64. *Fisher v. City of Berkeley*, 475 U.S. 260 (1986); *Town of Hallie v. City of Eau Claire*, 471 U.S. 34 (1985).

The first case was *Town of Hallie*, involving allegations that a city active in the sewage-treatment business had made tying agreements that violated the Act's section 1.⁶⁵ It was thus an implied exemption case, with the municipality acting as market participant rather than lawmaker, and the Court again reached a sound result. The Court reaffirmed that a municipality seeking an implied exemption must meet the clear articulation requirement,⁶⁶ thereby emphasizing that the logic of an implied exemption requires a state regulatory scheme more specific than a "home rule" amendment. But the Court also held that a municipality unlike a private firm can qualify for an exemption without showing active supervision.⁶⁷ This too is defensible: municipalities are, after all, run by public officials, and so there may be little point in requiring states to appoint another layer of officials to supervise municipal conduct. To ensure that the city's conduct furthered a state regulatory scheme, the Court instead required evidence in the form of statutory language that the conduct had been "contemplated" by state legislators.⁶⁸

Although the *Town of Hallie* result seems reasonable, the Court's opinion has nevertheless been a source of troubles. The reason is that the Court failed to make clear that its logic applied only to implied exemption claims; indeed, the Court cited preemption and implied exemption precedents indiscriminately.⁶⁹ This opened two pitfalls in subsequent preemption cases. First, courts have interpreted *Town of Hallie* to mean that clear articulation—normally a meaningless but harmless requirement in preemption analysis—must be shown at the *state* level in a defense to a preemption claim against a municipality, and therefore that states may not use home rule amendments to empower municipalities to enact ordinances that displace competition.⁷⁰ Such holdings have drawn widespread criticism for interposing federal law into state decisions regarding which level of state government is the optimal regulator,⁷¹ decisions which conspicuously have nothing to do with the purpose of the Sherman Act. Second, the active supervision requirement serves different purposes in preemption and implied exemption cases, and in preemption cases cannot be replaced by *Town of Hallie*'s "contemplated" standard.

The Supreme Court tumbled into both of these pitfalls in *City of Berkeley*,⁷² the case marking the next step in the Court's hasty retreat from *City*

65. *Town of Hallie*, 471 U.S. at 36-37.

66. *Id.* at 40.

67. *Id.* at 46-47.

68. *Id.* at 44.

69. *Id.* at 38-40 (citing preemption decisions *Parker* and *Midcal* and implied exemption decision *City of Lafayette*, as well as *City of Boulder*, which the Court had treated as an implied exemption case).

70. *See, e.g.*, *Hertz Corp. v. City of New York*, 1 F.3d 121, 128 (2d Cir. 1993).

71. *See, e.g.*, Einer R. Elhauge, *The Scope of Antitrust Process*, 104 HARV. L. REV. 667, 675-76 (1991).

72. *Fisher v. City of Berkeley*, 475 U.S. 260 (1986).

of *Boulder*. *City of Berkeley* consisted of a claim by landlords that the Sherman Act preempted a city's rent-control scheme.⁷³ As in *City of Boulder*, this was a municipality acting as lawmaker rather than market participant, and therefore the Court again got into trouble. It rejected the landlords' preemption claim by holding that the city council in imposing rent control had acted "unilaterally"—that is, without making an agreement with anyone else—and thus had not violated the Act's section 1.⁷⁴

Of course, the proposition that a city does not violate the Sherman Act merely by enacting a regulatory ordinance—even if that ordinance might conflict with the Act—was exactly what the Court should have made clear in *City of Boulder*. But, as in *Parker*, this holding had no place in *City of Berkeley*: the claim was not that the city had committed a Sherman Act violation, but rather that a city ordinance conflicted with the Act and therefore was unenforceable.⁷⁵ The Court's conflation of preemption and violation thus continued unabated, revealing that the lesson of *City of Boulder* had gone unlearned. Indeed, there is a kind of madcap circularity here: *City of Boulder* suggests that a city can violate the Sherman Act by enacting an ordinance that conflicts with the Act, but *City of Berkeley* holds that an ordinance conflicts with the Act only if the city by enacting the ordinance committed an antitrust violation.

Another problem with *City of Berkeley* was that the Court's emphasis on "unilateral" state action did not seem to distinguish *Midcal*, decided six years earlier. After all, *Midcal* had also involved a regulatory scheme that was simply a "unilateral" legislative enactment created without agreement between the state lawmaking body and anyone else. But the Court had struck down the *Midcal* regime anyway. To reconcile this holding, the Court in *City of Berkeley* announced that the seemingly unilateral *Midcal* statute had in fact been "hybrid," meaning that the state had enacted a statute enabling private firms to

73. *Id.* at 262-63.

74. *Id.* at 267-69. The landlords also claimed that the city had violated the Act's section 2, which unlike section 1 does not require an agreement. *Id.* at 270 n.2. But the Court ruled that the landlords "have not pressed the [section 2] point with any vigor" and dismissed the claim on grounds that it "goes beyond the scope of the facial challenge presented here." *Id.*

75. Judge Merrick Garland has similarly noted that the Court's *City of Berkeley* analysis is inapt because "the existence of a substantive violation of the Sherman Act was not the issue"; the landlords were rather seeking an injunction, "the classic remedy in preemption cases." Merrick B. Garland, *Antitrust and State Action: Economic Efficiency and the Political Process*, 96 YALE L.J. 486, 503, 504 (1987). Judge Garland nonetheless ultimately endorses an approach whereby "preemption analysis collapses into the *Midcal* test," by which he means the clear articulation and active supervision requirements. *Id.* at 507. Judge Garland thus notices as a formal matter the Court's confusion in *City of Berkeley*, but he still adopts the Court's ultimate conclusion that implied exemption and preemption questions are analytically indistinct.

dictate resale prices, and the firms had then done so.⁷⁶ The implication was that this one-two punch of public then private action marked a kind of collusion, and therefore that *Midcal* involved an agreement after all. By contrast, the city council in *City of Berkeley* had both enacted the regulatory regime and appointed public officials to set prices,⁷⁷ and therefore its rent-control scheme lacked *Midcal*'s "hybrid" aspect. The Court in *City of Berkeley* thereby found a second fictional violation in the *Midcal* fact pattern: the *Midcal* opinion, as I have noted, relies upon a non-existent agreement between wine producers and wholesalers; the *City of Berkeley* opinion then distinguishes *Midcal* by citing a non-existent agreement between those same wine producers and the state.

Judge Merrick Garland has correctly observed that *City of Berkeley*'s unilateral-hybrid distinction is just the active supervision requirement relabeled.⁷⁸ Why then did the Court bother to introduce this new framework when it could have distinguished *Midcal* simply by noting that the rent-control scheme satisfied active supervision while the *Midcal* regime did not? The apparent answer is that the Court had foundered upon the two *Town of Hallie* pitfalls. The Court had established in *Town of Hallie* that a municipality can qualify for "immunity" without showing active supervision, and yet the Court could not now cite that holding without irresponsibly implying that the rent-control regime would have been valid even if it had empowered private parties rather than public officials to dictate rents. Also, the Justices apparently thought *Town of Hallie* meant that municipalities must show clear articulation at the state level in a preemption case, which the *City of Berkeley* city council arguably could not do.⁷⁹ So the Court felt compelled to disregard its state-action immunity doctrine as developed through *Town of Hallie*, and instead to invent the unilateral-hybrid framework, which served the Court's twin needs to reanimate active supervision and jettison clear articulation—clear articulation being, as I have noted, irrelevant to preemption analysis anyway. Far easier, of course, would have been for the Court to push *Town of Hallie* aside by observing that it was an implied exemption decision whose reasoning did not apply in a preemption case. But that solution was not available to a Court which remained, despite the furor over *City of Boulder*, unable to distinguish questions of violation and preemption in its antitrust jurisprudence.

76. *City of Berkeley*, 475 U.S. at 268-69.

77. *Id.* at 262.

78. See Garland, *supra* note 75, at 507.

79. Compare *City of Berkeley*, 475 U.S. at 272 (Powell, J., concurring) (arguing that the state specifically authorized the city's rent-control ordinance), with *id.* at 279-80 (Brennan, J., dissenting) (arguing that the state did not specifically authorize that type of rent control).

D. *A Bad Choice Between Ignoring Conflict and Inventing "Violation"*

The implications of the Court's confusion of violation and preemption extend well beyond the Court's decisions involving municipalities, even if those decisions are the most notorious victims of that confusion in the Court's own jurisprudence. Because competition-displacing state laws are abundant, lower courts are regularly asked to make sense of the Court's insistence that a state law must involve an antitrust "violation" to be invalid under the Sherman Act. Judges have responded with either of two approaches, depending largely on whether they heed the fact that none of the state laws struck down by the Supreme Court on antitrust grounds has actually entailed illegal conduct. Unfortunately, neither approach leads to sound outcomes.

Many judges have taken the violation requirement literally, thereby insisting that a state law is unenforceable only if it requires or rewards market conduct the Sherman Act prohibits. The nominal virtue of this literalist approach is predictability: a court evaluates a state law by applying the same antitrust rules it would use to assess the conduct of a market participant. But with such predictability come results that cannot be squared with federal antitrust policy. The problem is that the definition of an antitrust violation rests upon judicial assumptions about market conduct that are widely inaccurate if applied to trade restraints instead imposed by lawmakers. S. Paul Posner and Paul Slater, two early *Parker*-doctrine commentators, observed that a state law can undermine the purpose of the Act's section 1 even if the law does not involve an agreement.⁸⁰ For example, a state could empower one firm to announce a price floor that legally binds all of its competitors.⁸¹ But conflict without violation probably occurs more often under the Act's section 2, in the form of state laws that create or protect monopolies. Although the Supreme Court has held that the Sherman Act's overarching purpose is to prevent "monopoly and the acts which produce the same result as monopoly,"⁸² the Court has never struck down a state law on antitrust grounds for making a monopoly. And most challenges to monopoly-protecting state laws have failed before lower courts as well, even when the state does not regulate the price the monopolist charges. The literalist approach to the Court's violation requirement explains why.

Two recent decisions by the Seventh Circuit show how the literalist approach causes courts to ignore the conspicuous Supremacy Clause questions raised by state laws that protect monopolies. In *Endsley v. City of Chicago*, motorists claimed that a city's operation of a busy toll road constituted an

80. Posner, *supra* note 18, at 701; Paul E. Slater, *Antitrust and Government Action: A Formula for Narrowing Parker v. Brown*, 69 NW. U. L. REV. 71, 78 (1974).

81. S. Paul Posner noted that *Schwegmann* appeared to involve state laws of this type. Posner, *supra* note 18, at 700-01.

82. *Standard Oil Co. v. United States*, 221 U.S. 1, 61 (1911).

illegal monopoly because the city collected more in tolls than was needed for the road's upkeep.⁸³ The court dismissed the suit by reasoning that a market participant violates the Sherman Act neither by becoming a monopolist nor by charging monopoly-level prices.⁸⁴ And in *Arsberry v. Illinois*, inmates claimed that the Act forbade a state from granting private companies exclusive licenses to sell telephone services at prisons, the companies in turn handing over to the state half the revenues they collected from prisoners.⁸⁵ Writing for the court, Judge Richard Posner held that a state "do[es] not violate the antitrust laws by charging fees or taxes that exploit the monopoly of force that is the definition of government."⁸⁶ And the phone companies themselves, mere "state concessionaires" in Judge Posner's view, did not violate the Act by charging high prices.⁸⁷ Thus, in both cases the court asked only whether the monopolist had engaged in conduct that constituted a Sherman Act violation. In neither case did the court address the distinct question whether monopoly-protecting state law conflicted with the Act and was therefore preempted—even though a preemption finding would have provided the injunctive relief sought by the plaintiffs in both cases.⁸⁸ One possible explanation is that in both cases the judges simply overlooked the preemption issue, perhaps because Supreme Court precedent makes preemption as a distinct category of antitrust claim largely invisible.⁸⁹ The other possibility is that the judges did notice the preemption issue but thought, again because of decisions such as *Midcal* and *Rice*, that the lack of an antitrust violation settled it.

The reasons, however, that courts have traditionally read the Act not to forbid mere possession of monopoly or charging of monopoly prices do not apply to a monopoly protected by state law. The lure of monopoly profits

83. 230 F.3d 276, 278 (7th Cir. 2000).

84. *Id.* at 283.

85. 244 F.3d 558, 561 (7th Cir. 2001).

86. *Id.* at 566.

87. *Id.*

88. The Local Government Antitrust Act of 1984, 15 U.S.C. §§ 35-36 (2006), precluded all but injunctive relief against the City of Chicago, the defendant in *Endsley*, 230 F.3d at 276. And principles of sovereign and qualified immunity would likely have prevented the payment of damages on the antitrust claims against the state and the public officials in *Arsberry*, 244 F.3d at 561.

89. Consistent with this interpretation is the fact that the *Endsley* and *Arsberry* plaintiffs apparently failed in their pleadings to distinguish explicitly between preemption and violation, which itself is likely attributable to the conflation of those concepts in the Supreme Court precedent to which the plaintiffs would have naturally looked for guidance. But a failure by the plaintiffs to use the term "preemption" should not have been fatal given that a preemption claim was implicit in the facts of both *Endsley* and *Arsberry*. Federal courts are required to construe pleadings liberally, and a complaint describing a real controversy in factual terms can be sustained even on a legal theory not "suggested or intended by the pleader." 5 CHARLES ALAN WRIGHT & ARTHUR R. MILLER, FEDERAL PRACTICE AND PROCEDURE § 1216 (3d ed. 2005).

induces competitive firms to pursue market share through innovation that benefits customers.⁹⁰ At the same time, monopoly profits are to rivals like a red flag to a bull, and so a firm pricing well above its marginal costs should soon experience an onrush of competition that drives prices down to competitive levels.⁹¹ Courts therefore damn only those forms of monopolistic market conduct that pay few social dividends and that rivals cannot readily discipline, such as predatory pricing in a market with entry barriers.⁹² But unless a monopoly-protecting state law is a reward for innovation—which is unlikely because monopoly as an innovation prize is traditionally the sole province of the federal patent system—such a law is unlikely to benefit consumers. Indeed, the intuition in that case goes the other way: compulsion is the refuge of the seller who cannot make customers come willingly. And a legally guaranteed monopoly is by definition insulated from the market forces that make most monopolies temporary.⁹³ For these reasons, a monopolist protected by state law but free to charge profit-maximizing prices is an even greater affront to federal antitrust policy than a monopolist who acquires that position solely through illegal market conduct. But the literalist approach passes over this fact, thereby elevating the formal definition of an antitrust violation over the substantive goals of antitrust.

Judges who have noticed the fictional nature of the violation requirement in decisions such as *Midcal* have an option other than the literalist approach. Taking their cues from the Supreme Court, these judges can use “violation” as mere shorthand for their conclusion that state law is inconsistent with federal antitrust policy. This non-literalist approach has the seeming potential to avoid the misplaced formalism characteristic of cases involving state-protected monopolies. Unfortunately, the approach’s hazards greatly outweigh this possible benefit. One such hazard is a vacuum of guidance: because the Supreme Court has insisted that the state laws it has struck down on antitrust grounds entailed true antitrust violations, the Court has never laid down principles that actually explain its decisions. The second, related hazard is that lower courts may similarly view the fictitious nature of the violation

90. See *Endsley*, 230 F.3d at 283 (“[V]irtually all business behavior is designed to enable firms to raise their prices above the level that would exist in a perfectly competitive market.”) (internal quotation marks omitted).

91. As Judge Posner has written (though not in *Arsberry*), “firms compete to become and to remain monopolists, and the process of competition erodes their profits.” *Blue Cross & Blue Shield United of Wis. v. Marshfield Clinic*, 65 F.3d 1406, 1412 (7th Cir. 1995).

92. See *Barry Wright Corp. v. ITT Grinnell Corp.*, 724 F.2d 227, 230 (1st Cir. 1983) (Breyer, J.) (noting that a firm is permitted to acquire or maintain a monopoly only through “legitimate means,” including “patents, superior product, business acumen, or historic accident”) (internal quotation marks omitted).

93. See *Standard Oil Co. v. United States*, 221 U.S. 1, 62 (1911) (noting that Congress recognized when enacting the Sherman Act the tendency of free markets to prevent monopoly “if no extraneous or sovereign power imposed it”).

requirement as dispensation from their normal institutional obligation to give a plausible account of their reasoning. The non-literalist approach thus lacks two of the most important safeguards of rigorous and predictable adjudication.

These hazards were realized in *Hertz Corp. v. City of New York*, an antitrust preemption challenge to a city ordinance that prohibited rental car companies from varying their prices based on a driver's place of residence.⁹⁴ The city argued that residence-based pricing imposes "social costs" by raising prices for minorities and the working poor.⁹⁵ When the case reached the Second Circuit, the court dutifully announced that its threshold task was to decide whether the ordinance entailed a "violation" of the Act's section 1.⁹⁶ Although the city ordinance did not encourage market conduct that the Sherman Act prohibits, the Second Circuit recognized from cases such as *Midcal* that illegal conduct is not in fact required for a state law to be preempted.⁹⁷ But what was required was harder for the Second Circuit to say, as none of the Supreme Court's state-action immunity decisions actually discuss that question, nor does any analyze an economic regulation that resembled the rental car ordinance.⁹⁸ So the Second Circuit decided to send the case back to the district judge, directing him to "balance" a variety of factors including not only the ordinance's economic impact on rental car companies but also the social benefits touted by the city—these being relevant according to the Second Circuit because of "federal values embodied in the thirteenth and fourteenth amendments."⁹⁹ The district judge ultimately decided that the ordinance was unenforceable because the city could not quantify with precision the degree to which residence-based pricing disproportionately burdens poor and minority drivers.¹⁰⁰

The *Hertz* result is arbitrary; there was no objective way to "balance" the ordinance's economic costs against the social benefits touted by the city. Under the Second Circuit's mandate, a ruling for the city would have been just as defensible as a ruling against. *Hertz* thus illustrates how the lack of traditional safeguards of analytic rigor tempts judges who follow the non-literalist approach to lapse into judicial freewheeling. Importantly, the case also shows that liberation from the formalism of the literalist approach does not ensure

94. 1 F.3d 121, 127 (2d Cir. 1993).

95. *Id.* at 124.

96. *Id.* at 126 (identifying the threshold question to be whether the ordinance is itself a "contract, combination or conspiracy").

97. *Id.* The Second Circuit also found that the rental car ordinance could not satisfy the clear articulation requirement. *Id.* at 128. By looking for clear articulation at the state level in a preemption case involving a municipality, the court fell into the first of the two *Town of Hallie* pitfalls.

98. *See id.* at 127 (reviewing the Court's *Parker*-line precedent and comparing the regime at issue in each decision to the *Hertz* ordinance).

99. *Id.* at 131.

100. *Hertz Corp. v. City of N.Y.*, 212 F. Supp. 2d 275, 280 (S.D.N.Y. 2002).

results that vindicate federal antitrust policy. As I explain more fully in Part II, the purpose of the Sherman Act is to prevent restraints on competition that transfer wealth from consumers to producers. But no provider of rental cars could have profited from the *Hertz* ordinance's ban on residence-based pricing.

The open-ended nature of *Hertz* notwithstanding, a few commentators have suggested that the Supreme Court's use of the term "violation" in cases such as *Midcal*, even though literally inaccurate, is not devoid of analytic content. For example, Phillip Areeda and Herbert Hovenkamp argued that the Court reached the right result in *Midcal* because the state regime at issue had "the same marketplace result" as illegal price-maintenance agreements.¹⁰¹ The implication is that judges could introduce rigor into the violation requirement by striking down only those state laws that are *analogous* to antitrust violations.¹⁰²

Alas, the facts of *Midcal* itself reveal why mere appeal to analogy cannot transform the Court's violation requirement into a workable preemption criterion. The degree to which the state regime in *Midcal* actually brought about the "same marketplace result" as illegal conduct is unclear: resale prices imposed by sellers, which is what *Midcal* entailed, may differ from those reached through agreement with buyers.¹⁰³ Moreover, the Supreme Court has long held that producer efforts to impose resale prices unilaterally—for example, by cutting off resellers who do not follow "suggested" price schedules—are categorically *legal* under the Sherman Act.¹⁰⁴ It therefore would have been at least as accurate for Areeda and Hovenkamp to say that the *Midcal* regime had the same marketplace result as conduct which does *not* violate the Sherman Act. Monopolies, which can result from both innovation (legal) and predatory pricing (illegal), are a source of similar ambiguity. A court could "resolve" such ambiguity by ignoring it; for example, if a state regime has the same marketplace result as a Sherman Act violation, the court could deem the fact of alternative, legal routes to that result irrelevant. But such an approach merely trades indeterminacy for overbreadth. Almost any economic regulation has the same market impact as some Sherman Act

101. 1 AREEDA & HOVENKAMP, *supra* note 5, ¶ 217b1; accord AREEDA ET AL., *supra* note 2, ¶ 164, at 91 (noting that the *Midcal* regime had the "same effect" as "an unlawful supplier-dealer arrangement").

102. See, e.g., Lopatka & Page, *supra* note 30, at 298 (arguing that courts can determine whether a state law meets the violation requirement by "process of analogy").

103. The Court originally banned resale price-fixing for fear that it would be used to promote a cartel at the resale level. See *Dr. Miles Med. Co. v. John D. Park & Sons*, 220 U.S. 373, 408 (1911). Scholars have noted, however, that this result is particularly unlikely when resale prices are imposed unilaterally by the upstream seller—which is what *Midcal* entailed—rather than through agreement between sellers and buyers. See E. THOMAS SULLIVAN & HERBERT HOVENKAMP, *ANTITRUST LAW, POLICY AND PROCEDURE: CASES, MATERIALS, PROBLEMS* 455-56 (5th ed. 2003).

104. *United States v. Colgate & Co.*, 250 U.S. 300, 307 (1919).

violation: laws that forbid banks and insurers from entering other lines of business, for example, have the same effect as agreements not to compete; the *City of Boulder* ordinance, which limited the neighborhoods in which a cable company could sell, had the same effect as a horizontal market division;¹⁰⁵ more broadly, any law that restricts market entry—such as a zoning code, professional licensing requirement, advertising restriction, or franchise tax—produces the same result as a concerted refusal to deal.¹⁰⁶ Moreover, almost all such arrangements are like the *Midcal* regime in their lack of active state supervision over market prices. No plausible reading of the Sherman Act suggests a congressional intention to cut down so many traditional forms of state economic regulation. For these reasons, a court cannot salvage the violation requirement simply by redefining it to mean “illegal conduct or the same result as illegal conduct.”

Ultimately, what matters are results, not terminology. If the Supreme Court had always made clear that “violation” in a preemption case means something other than illegal market conduct, and had also given the term a rigorous alternative definition suitable to the preemption context, the Court’s *Parker*-line decisions would require close reading but might otherwise be unproblematic. The problem is not the term; it is the confusion that the Court’s use of the term betrays. The Court has referred to “violation” in preemption cases precisely because the Court has failed to identify antitrust preemption as a distinct legal question: hence *Parker*’s irrelevant discussion of whether state officers had engaged in illegal market conduct; hence the Court’s difficulties in cases where municipalities act as lawmakers rather than market participants; hence the Court’s indiscriminate application of the same doctrinal elements regardless of whether the enforceability of federal or state law is at stake. The better approach to “violation” is therefore to recognize it as an outgrowth of a fundamental confusion, and to relegate it to its natural home in implied exemption cases. The way would then be cleared in preemption analysis for overt application of Supremacy Clause principles, a task to which I now turn.

105. *Cnty. Commc’ns Co. v. City of Boulder*, 485 F. Supp 1035, 1038 (D. Colo. 1980) (noting that the ordinance restricted the geographic areas in which the plaintiff cable company could operate).

106. A concerted refusal to deal (also sometimes called a group boycott) occurs when firms conspire to exclude a competitor, often through agreements with the competitor’s suppliers. *See Nw. Wholesale Stationers, Inc. v. Pac. Stationery & Printing Co.*, 472 U.S. 284, 298 (1985) (holding that a joint venture which excludes a competitor is subject to a rule of *per se* illegality if it “possesses market power or unique access to a business element necessary for effective competition”); *Klor’s, Inc. v. Broadway-Hale Stores, Inc.*, 359 U.S. 207, 212-13 (1959) (condemning a concerted refusal to deal for its tendency to reduce the number of competitors in a market).

II. DEFINING THE SHERMAN ACT'S PREEMPTIVE REACH

In this Part, I use principles of preemption to derive and apply rules for determining when federal antitrust law renders state economic regulation unenforceable. My proposed rules would largely replace the Court's state-action immunity doctrine in preemption cases, and also in implied exemption cases where the issue is the validity of the underlying state regulatory scheme rather than whether a defendant's conduct made that scheme cheaper to administer. Specifically, my proposed rules would supersede the Court's violation and clear articulation requirements, confining these to the implied exemption context. On the other hand, I do find a use in preemption doctrine for the Court's active supervision requirement, but only if defined narrowly to mean state control over market prices.

My proposed rules would be judge-made, which raises a threshold question. The preemptive scope of federal antitrust law is ultimately a question of congressional intent (at least to the extent that Congress does not overreach the Commerce Clause). And Congress unlike courts is not bound under principles of *stare decisis* to pay deference to previous judicial interpretations of the Sherman Act. Why then do I propose new judge-made rules rather than new legislation?

Despite the superficial merits of a congressional solution, I believe that a judicial fix is both possible and preferable. It is possible because, the dignity of precedent notwithstanding, courts that have tangled themselves in confused doctrine are not permitted simply to sit down and wait for Congress to rescue them. They must soldier on, cutting through thickets of their own creation if necessary. It is for this reason that principles of *stare decisis* permit courts to depart from precedent that is "badly reasoned,"¹⁰⁷ marked by "indeterminacy,"¹⁰⁸ or a "continuing source of confusion."¹⁰⁹ And there are few surer recipes for confusion and indeterminacy than the Court's violation requirement, which is contradicted by the facts of every state-action immunity case in which the Court has blocked enforcement of state law, and which causes judges to ignore basic questions such as whether a litigant wishes federal or state law declared unenforceable. Also, adherence to precedent is

107. *United States v. Dixon*, 509 U.S. 668, 712 (1993) (quoting *Payne v. Tennessee*, 501 U.S. 808, 827 (1991)). Although the case for fidelity to precedent is usually stronger in matters of statutory rather than constitutional interpretation, the Supreme Court has established that the federal antitrust statutes are an exception. *See State Oil Co. v. Khan*, 522 U.S. 3, 20-21 (1997).

108. *Veith v. Jubelirer*, 541 U.S. 267, 283 (2004) (Scalia, J., plurality opinion).

109. *Dixon*, 509 U.S. at 710; *see also Nichols v. United States*, 511 U.S. 738, 744-45 (1994) (noting that precedent may be overruled if it lacks a "coherent rationale" and creates "confusion in the lower courts").

supposed to promote “reliance on judicial decisions,”¹¹⁰ but no good can come from reliance on jurisprudence that is inherently misleading. State legislators who searched for antitrust cases in which the Supreme Court actually mentions preemption would find only those decisions (such as *Rice*) in which the Court faithfully applies the violation requirement to uphold the state law in question. The decisions (such as *Midcal*) that are most relevant to legislators—in which the Court strikes down state law despite the lack of a violation—do not even mention preemption, and thus lie as traps for the unwary. And even these decisions do not *announce* that the violation requirement is a fiction; legislators can detect this crucial fact only if they also understand the complicated antitrust definition of a vertical price-fixing agreement. Finally, legislators who discover the truth about the violation requirement are not thereby rewarded with clear drafting instructions: not even the best-informed lawmakers could reliably legislate around the type of open-ended judicial analysis seen in *Hertz*.

Not only is the Supreme Court therefore permitted to reconsider its antitrust preemption decisions, but it is better positioned than Congress to do so. As the Supreme Court has already recognized, “the general presumption that legislative changes should be left to Congress has less force with respect to the Sherman Act.”¹¹¹ The reason is that the Act’s textual vagueness is deliberate. As explained by Senator John Sherman, who introduced the Act, Congress can only “declare general principles” in the antitrust realm; “the precise line between lawful and unlawful combinations . . . must be left for the courts to determine in each particular case.”¹¹² The Supreme Court has therefore held that Congress “expected the courts to give shape to the statute’s broad mandate by drawing on common-law tradition,”¹¹³ a tradition that includes the overruling of decisions whose “theoretical underpinnings . . . are called into serious question.”¹¹⁴ There is no reason to think that congressional expectations in this regard are different—or should be—when the question is the Sherman Act’s application to state lawmakers rather than market participants.

The superiority of a judicial solution does not, of course, mean that courts may substitute their will for Congress’s. The judicial task is to find ways of vindicating Congress’s “general principles” given the exigencies of specific cases, which include not only the institutional limitations of courts but also the nature of the litigants. For this reason, in the discussion that follows I emphasize how the incentives that face state lawmakers and the peculiar impact

110. *United States v. IBM Corp.*, 517 U.S. 843, 856 (1996) (quoting *Payne*, 501 U.S. at 828).

111. *Khan*, 522 U.S. at 20.

112. 21 CONG. REC. 2460 (1890).

113. *Nat’l Soc’y of Prof’l Eng’rs v. United States*, 435 U.S. 679, 688 (1978).

114. *Khan*, 522 U.S. at 21.

of trade restraints backed by force of law suggest antitrust rules different from those that courts apply to market participants.

A. *Congress's Antitrust "Purposes and Objectives"*

Preemption is traditionally divided into three types: express, field, and conflict.¹¹⁵ The Sherman Act makes no mention of state economic regulation, ruling out express preemption. And the Act's broad but spare language on market conduct cannot support an inference that Congress meant to take the entire field of economic regulation away from the states.¹¹⁶ Indeed, the Act was not even intended to occupy the field of antitrust: legislative history suggests that Congress aimed to supplement rather than supplant state laws against restraints of trade,¹¹⁷ a view of the Act the Supreme Court has mostly adopted.¹¹⁸

That leaves conflict preemption, which—as the Court established in *Davidowitz*—occurs when state law “stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.”¹¹⁹ The first step, then, in deriving an antitrust preemption doctrine is to describe Congress's “purposes and objectives” for the Sherman Act.

I have already remarked upon the Sherman Act's textual breadth; the statutory language prohibits *every* agreement in restraint of interstate trade and bid for interstate monopoly. And yet Congress could not possibly have meant such a general proscription. As Justice Brandeis observed, an intention to restrain trade of some form is the “very essence” of every commercial contract.¹²⁰ The issue, about which the text is silent, is the criteria that courts should use to decide which among the many types of interstate restraints and monopolies to condemn.

115. SULLIVAN & GUNTHER, *supra* note 19, at 329; *see also* Hillsborough County v. Automated Med. Labs., 471 U.S. 707 (1985).

116. *See* Rice v. Santa Fe Elevator Corp., 331 U.S. 218, 229 (1947) (finding that field preemption may occur when “[t]he scheme of federal regulation [is] so pervasive as to make reasonable the inference that Congress left no room for the States to supplement it”).

117. 21 CONG. REC. 2456-57 (1890).

118. California v. ARC Am. Corp., 490 U.S. 93, 105-06 (1989) (holding that a state may create a right of action for indirect purchasers of goods tainted by price-fixing even though federal antitrust law only permits suit by direct purchasers). *But see* Flood v. Kuhn, 407 U.S. 258, 284 (1972) (holding that a state law is preempted to the extent it would interfere with Major League Baseball's federal antitrust exemption).

119. Hines v. Davidowitz, 312 U.S. 52, 67 (1941); *see also* Hillsborough County, 471 U.S. at 713 (quoting *Davidowitz*, 312 U.S. at 67).

120. Chi. Bd. of Trade v. United States, 246 U.S. 231, 238 (1918); *accord* Standard Oil Co. v. United States, 221 U.S. 1, 54 (1911) (establishing that the Act applies only to restraints of trade and bids for monopoly that are “unreasonable”).

Although the Act's legislative history does not resolve every ambiguity in the statutory text,¹²¹ it does suggest two criteria that courts have used to circumscribe the statute's reach. Not every member of Congress who voted for the Act would have emphasized both of these criteria, but each identifies a concern that motivated many of the Act's principal legislative supporters. One criterion is harm to consumers. Much of the Act's legislative history reflects congressional distress about business combinations that could injure consumers by raising prices.¹²² Senator Sherman lamented that "[t]he price to the consumer depends upon the supply, which can be reduced at pleasure by the combination."¹²³ Congress's fear of consumer injury finds support in classical economic theory, which notes the ability of monopolies and cartels to raise prices above the levels that would prevail under free competition.

The second criterion embraced by much of Congress for condemning trade restraints and monopolies is a motive to enrich producers. Again, Senator Sherman articulated this criterion succinctly, stating that the Act targets competitive restraints which "increase the profits of the producer at the cost of the consumer."¹²⁴ More generally, the legislative history is replete with invective directed at the self-seeking conduct of large business combinations.¹²⁵ By contrast, the same history contains a colorful discussion in which several senators expressed doubt that the Act should be interpreted to forbid efforts by temperance societies to close down saloons.¹²⁶ Consistent with this history, courts refuse to extend the Act's prohibitions to trade restraints not marked by a goal of producer enrichment. For example, the Supreme Court has observed that civil rights protestors did not violate the Act when they organized a group boycott of allegedly racist merchants.¹²⁷ Lower courts have similarly denied liability on Sherman Act claims against producers who agreed to limit competition for social or political motives, in each case finding that the defendants lacked a "revenue maximizing purpose,"¹²⁸ pursued no "competitive or commercial advantage,"¹²⁹ or some similar formulation.

121. See AREEDA ET AL., *supra* note 2, ¶ 130, at 36 ("[T]he legislative history lacked careful weighing and deliberate choices on many key issues where conflicts—perhaps then largely unforeseen—have subsequently arisen.").

122. For a thorough recounting of instances in the legislative history where congressmen blamed "trusts" for overcharging customers, see Robert H. Lande, *Wealth Transfers as the Original and Primary Concern of Antitrust: The Efficiency Interpretation Challenged*, 34 HASTINGS L.J. 65, 94-96 (1982).

123. 21 CONG. REC. 2460 (1890).

124. *Id.*

125. See Elhauge, *supra* note 71, at 699-701 (summarizing legislative history).

126. 21 CONG. REC. 2658-59 (1890).

127. *FTC v. Superior Court Trial Lawyers Ass'n*, 493 U.S. 411, 426 (1990) (citing *NAACP v. Claiborne Hardware Co.*, 458 U.S. 886, 914 (1982)).

128. *United States v. Brown Univ.*, 5 F.3d 658, 672 (3d Cir. 1993) (denying claims against universities who agreed to fix financial aid awards).

129. *Allied Int'l, Inc. v. Int'l Longshoremen's Ass'n, AFL-CIO*, 640 F.2d 1368, 1380

More controversial than these two criteria, and ultimately less persuasive to judges, has been a view of antitrust that values economic smallness—that is, markets characterized by numerous, small sellers—even when not beneficial to consumers. Proponents of this view argue that Congress intended the Sherman Act to protect the livelihood of lesser producers, the “small dealers and worthy men” of Justice Peckham’s famous dictum.¹³⁰ While this view of antitrust is not without foundation in the legislative history,¹³¹ it would not characterize an antitrust preemption doctrine attractive to most courts today. Recent decades have seen the pro-consumer view come to dominate the Supreme Court’s antitrust jurisprudence, with the Court treating harm to consumers as the sine qua non of “anticompetitive” conduct¹³² and rejecting the notion that the Act forbids conduct harmful only to producers.¹³³ A viable preemption doctrine would have to reflect this evolution in the Court’s jurisprudence because a consistent view of congressional intent as applied to both market conduct and state law deflects accusations that antitrust preemption is merely a stalking horse for the economic policy preferences of individual judges.

Courts will, moreover, place a premium on political cover when the question is whether federal law blocks a state’s efforts to regulate economic competition. The reason is *Lochner v. New York*, a 1905 case in which the Supreme Court held that a state could not abridge liberty of contract by setting maximum work hours for bakers.¹³⁴ The *Lochner* majority tried to ground its holding in the Fourteenth Amendment, but it ultimately failed to persuade later

(1st Cir. 1981) (discussing claims against longshoremen who protested the Soviet invasion of Afghanistan by boycotting a Russian-goods importer), *aff’d sub nom.* Int’l Longshoremen’s Ass’n, AFL-CIO v. Allied Int’l, Inc., 456 U.S. 212 (1982).

130. *United States v. Trans-Missouri Freight Ass’n*, 166 U.S. 290, 323 (1897).

131. In places, the legislative history seems to suggest that small businesses rather than consumers are the primary victims of large combinations. *See* HANS B. THORELLI, *THE FEDERAL ANTITRUST POLICY: ORIGINATION OF AN AMERICAN TRADITION* 226-27 (1954). In many cases this diversity of legislative beneficiaries implies no contradiction: consumer and small-producer interests align against a firm that seizes market share through, for example, successful predatory pricing. But consumer interests switch sides when a producer instead gains share by innovating more quickly than rivals, or when less efficient producers survive off of the higher prices made possible by a cartel.

132. *Atl. Richfield Co. v. USA Petroleum Co.*, 495 U.S. 328, 339-40 (1990); *see also Reiter v. Sonotone Corp.*, 442 U.S. 330, 343 (1979) (holding that legislative history indicates that Congress intended the Sherman Act to be a “consumer welfare prescription”) (quoting ROBERT H. BORK, *THE ANTITRUST PARADOX: A POLICY AT WAR WITH ITSELF* 66 (1978)).

133. For example, in *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993), the Court held that below-cost pricing by an alleged price predator does not violate federal antitrust law unless the predator would likely recoup his losses through higher prices after achieving market power. The Court rejected the notion that mere harm to other producers is an antitrust concern: “Even an act of pure malice by one business competitor against another does not, without more, state a claim under the federal antitrust laws” *Id.* at 225.

134. 198 U.S. 45 (1905).

Justices that its preference for laissez-faire had an external legal foundation.¹³⁵ Judges across the ideological spectrum now try to outdo each other in denouncing *Lochner*, marking a broad consensus that principles whereby courts use federal law to cut down state economic regulation should not originate in the judicial branch.¹³⁶ *Lochner* therefore stands in the way of those who might otherwise view preemption doctrine as an opportunity to restore theories of antitrust now in exile.

My proposed doctrine would thus condition preemption on both producer enrichment and consumer injury; it would not condemn a state law harmful only to small producers. Many common types of regulation are safe under these criteria. For example, rent-control laws would be beyond preemption because they are not meant to enrich producers; the same is true of laws that prevent producers from varying their prices in order to increase profits, such as the rental-car ordinance in *Hertz*. Also safe would be laws that impose costs more or less uniformly across producers; such laws increase prices but not producer profits.¹³⁷ Tax laws, as well as health and safety regulations, are normally of this type.

At the same time, numerous state laws do run afoul of both of the preemption criteria I have so far identified. Some, such as minimum wage laws, have an express purpose to transfer wealth from consumers to producers.¹³⁸ Others harm consumers for the benefit of a mixed group that

135. See, e.g., *West Coast Hotel Co. v. Parrish*, 300 U.S. 379 (1937) (abrogating *Lochner* by holding that the Fourteenth Amendment contains no substantive right to freedom of contract).

136. See, e.g., *Kelo v. City of New London*, 125 S. Ct. 2655, 2683 (2005) (Thomas, J., dissenting) (quoting approvingly from Justice Holmes's *Lochner* dissent); *United States v. United Foods, Inc.*, 533 U.S. 405, 429 (2001) (Breyer, J., dissenting) (rejecting *Lochner*'s holding that the Due Process Clause restricts "the Government's economic regulatory choices"); *Alden v. Maine*, 527 U.S. 706, 814 (1999) (Souter, J., dissenting) (lamenting "the *Lochner* era's industrial due process"). The left and right ends of the political spectrum often arrive at their denunciations of *Lochner* by different paths, as illustrated by the accusations of Lochnerism exchanged between Justices Scalia and Breyer in *College Savings Bank v. Florida Prepaid Postsecondary Education Expense Board*, 527 U.S. 666 (1999). Justice Scalia defined Lochnerism as the judicial imposition of economic theories not supported by authoritative text, *id.* at 691, while Justice Breyer defined it as judicial interference with legislative flexibility, *id.* at 701. Both concerns can arise when judges use the antitrust laws to strike down state economic regulations. See, e.g., *Dolan v. City of Tigard*, 512 U.S. 374, 406-07 (1994) (Stevens, J., dissenting) (criticizing *Lochner* as a "potentially open-ended source[] of judicial power to invalidate state economic regulations that [judges] view as unwise or unfair").

137. By uniform I do not necessarily mean that costs rise by equal amounts across all producers. Instead, I mean that costs increase in ways that do not provide some producers with an ongoing advantage irrespective of their ability to provide value to consumers. For example, an advertising restriction might impose non-uniform costs because its burden will fall more heavily on upstarts than incumbents.

138. My example refers to the consumers and producers of labor: employers and

includes but is not limited to producers. This is normally true of regulations that restrict market entry: zoning codes, for example, tend to protect both property owners from negative externalities and local retailers from competition; restrictions on alcohol and cigarette advertising insulate children from vice and incumbent sellers from upstarts; and professional licensing requirements arguably keep doctors and lawyers competent, which is good for the public, and scarce, which is good for the doctors and lawyers.

To be sure, many lawmakers who support regulations that impose entry barriers might have in mind some purpose other than producer enrichment. But at least under the bright-line rules courts normally apply in antitrust cases to decide difficult questions of motive, the possibility of benefits to non-producers is irrelevant: any taint of producer enrichment sullies the whole.¹³⁹ For example, the Supreme Court held that a strike for higher wages by public defenders was damned by the defenders' "undenied objective" to achieve their own "economic advantage," even though the defenders might also have wished to secure better representation for their indigent clients.¹⁴⁰ In addition, courts typically treat the fact that conduct enriches its perpetrator as conclusive evidence that such was its purpose,¹⁴¹ with one court explaining that this "objective test" avoids the "manipulation or circumvention" that can mar inquiries into subjective intent.¹⁴²

At this point, a tension becomes evident between a preemption doctrine extrapolated on straight lines from Congress's general antitrust "purposes and objectives" and Congress's likely expectations for antitrust preemption in particular. State laws that transfer wealth from consumers to producers are, as I have noted, extremely common. And there are several good reasons to think that Congress did not intend to work a revolution in federal-state relations by placing all such laws on the chopping block.¹⁴³ One reason, to which the Court

workers. But wage-and-hour laws also raise end-product prices and therefore injure final consumers of goods and services as well.

139. *See generally* *United States v. Brown Univ.*, 5 F.3d 658, 677-78 (3d Cir. 1993) (collecting Supreme Court decisions).

140. *FTC v. Superior Court Trial Lawyers Ass'n*, 493 U.S. 411, 426 (1990). The Court likewise rejected an argument that the danger to the general public from shoddy construction work justified an ethical rule prohibiting competitive bidding among engineers. *Nat'l Soc'y of Prof'l Eng'rs v. United States*, 435 U.S. 679, 693 (1978) (noting that the rule's immediate object was to "maintain the price level" and thereby enrich the rule's adherents).

141. *See, e.g., Va. Vermiculite, Ltd. v. W.R. Grace & Co. Conn.*, 156 F.3d 535, 539-41 (4th Cir. 1998) (noting that the potential for a non-profit organization to benefit financially by arranging a land donation suggests that the organization "had other goals beyond [land] preservation" and therefore was subject to antitrust liability for its conduct).

142. *Adidas Am., Inc., v. Nat'l Collegiate Athletic Ass'n*, 40 F. Supp. 2d 1275, 1286 (D. Kan. 1999) (citing 1 *AREEDA & HOVENKAMP, supra* note 5, ¶ 262).

143. *Accord Exxon Corp. v. Governor of Md.*, 437 U.S. 117, 133 (1978) (rejecting an antitrust preemption challenge because "if an adverse effect on competition were, in and of itself, enough to render a state statute invalid [under federal antitrust law], the States' power

seemingly alluded in *Parker*,¹⁴⁴ is a federalism-based canon of statutory construction whereby courts interpret a federal statute's silence on preemption questions to weigh against an invasion of traditional state prerogatives.¹⁴⁵ This canon's justification is admittedly weak as applied to the Sherman Act because the Supreme Court in 1890 deemed Congress's reach under the Commerce Clause to fall short of activity occurring entirely within a state's borders.¹⁴⁶ The text's silence could thus merely reflect Congress's begrudging acknowledgment of limitations then imposed by judges. But even though Congress may have felt that its hands were tied, we also have evidence that Congress intended to leave intact some state regulation it thought it could preempt. This evidence includes Senator Sherman's intimations on the congressional record that private firms should enjoy less power than states to restrain economic competition.¹⁴⁷ It also includes the 1904 case *Olsen v. Smith*, in which the Supreme Court held that the Act did not prevent Texas from restricting entry and capping prices in the pilotage market for the port of Galveston.¹⁴⁸ *Olsen* involved the instrumentalities of international maritime trade, and it was decided by the same Justices who one year later revealed the Court majority's anti-regulation bias in *Lochner*. *Olsen* therefore establishes that not even the *Lochner* Court, sitting during the era of the Sherman Act's enactment, was willing to read into the Act a congressional intention to preempt all competition-displacing state schemes—even when a scheme reached into the narrow crease where state and federal regulatory powers were then acknowledged to overlap.¹⁴⁹ The implication is that a permissive approach to state law remains consistent with congressional intent notwithstanding that the Supreme Court now gives Congress a much wider regulatory berth.

We therefore see that the twin criteria of producer enrichment and consumer injury, while decisive in the conduct realm, cannot be the only boundary markers of a preemption doctrine faithful to congressional intent. To prevent the Sherman Act from cutting down a swath of state law far wider than

to engage in economic regulation would be effectively destroyed”).

144. The Court's actual statement was: “In a dual system of government in which, under the Constitution, the states are sovereign . . . , an unexpressed purpose to nullify a state's control over its officers and agents is not lightly to be attributed to Congress.” *Parker v. Brown*, 317 U.S. 341, 351 (1943). This contains the federalism sentiment but oddly couches it in terms of a state's ability to control its officers rather than regulate its economy. The impression once again is that the Court had confused the preemption claim in the case for an unpled allegation that state officers had violated the Act and were thus subject to liability.

145. See Posner, *supra* note 18, at 704.

146. 1 AREEDA & HOVENKAMP, *supra* note 5, ¶ 216a.

147. 21 CONG. REC. 2459-60 (1890).

148. 195 U.S. 332, 344-45 (1904).

149. *Id.* at 341 (“[A]lthough state laws concerning pilotage are regulations of commerce, they fall within that class of powers which may be exercised by the States until Congress has seen fit to act upon the subject.”) (internal quotation marks omitted).

Congress plausibly intended, additional limiting criteria are needed. Unfortunately, the legislative record does not suggest criteria other than those I have already identified. Therefore, 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.

Deferential, that is, but not toothless. Although Congress would have expected the Sherman Act to have only modest implications for state law, it almost certainly did not expect the Act to lack preemptive force altogether. Unless a federal statute says otherwise, the Supreme Court presumes that Congress meant to preempt state laws that conflict with Congress's statutory scheme.¹⁵⁰ And Congress confirmed this presumption as applied to the Sherman Act when, after amending the Act in 1937 to let states decriminalize certain vertical price-fixing agreements,¹⁵¹ it repealed those amendments in 1975.¹⁵² Repeal would have served no purpose unless Congress assumed a default regime whereby state law in direct contravention of the Act is invalid.

B. Preemption Criteria Suggested by Previous Commentators

Possible limiting criteria in addition to those I have so far identified can be found in the work of previous commentators, who like me have expressed dissatisfaction with the state-action immunity doctrine and have therefore proposed reform. These commentators have not, however, recognized that the systemic defect in current doctrine is its failure to break out antitrust preemption as a distinct legal question. For this reason, their reform proposals generally fail to heed the Supremacy Clause requirement that the criteria whereby judges use a federal statute to strike down state law vindicate Congress's statutory objectives.

John Cirace, for example, has proposed a preemption doctrine based on allocative efficiency: he would invalidate any competition-reducing state law unless the law is no broader than necessary to correct "market failure," by which he means economic activity that does not maximize wealth creation.¹⁵³ A threshold objection to this proposal is that it is not limited to state laws that enrich producers; Cirace would condemn even a sales tax if levied inefficiently. Given, however, the evidence that the normative attractiveness of wealth creation lies behind the judicial popularity of the pro-consumer view of

150. *Nw. Cent. Pipeline Corp. v. State Corp. Comm'n*, 489 U.S. 493, 509 (1989).

151. Fair Trade Act, Pub. Law No. 314, 50 Stat. 693 (1937) (amended 1975).

152. Consumer Goods Pricing Act of 1975, Pub. Law No. 145, 89 Stat. 801 (1975).

153. John Cirace, *An Economic Analysis of the "State-Municipal Action" Antitrust Cases*, 61 TEX. L. REV. 481, 498 (1982).

antitrust,¹⁵⁴ it is nevertheless worth asking whether efficiency as a criterion in addition to (rather than instead of) those I have already identified yields a preemption doctrine consistent with congressional intent. The answer, alas, is no. Dispensation for wealth-maximizing state laws would not in fact do much to hem in the Sherman Act's preemptive scope: most competition-reducing economic regulations—including wage-and-hour rules, Sunday or late-hour closing laws, and licensing requirements—cannot plausibly be described as responses to any type of regularly occurring market failure. To the contrary, such laws usually reflect legislative judgments that goals other than wealth maximization should prevail. And even those regulations which are directed at actual market failure, such as many environmental and zoning laws, would often trip on Cirace's "no broader than necessary" hedge. Cirace acknowledges the invasiveness of his approach but does not address the consequent clash with congressional intent.¹⁵⁵

John Wiley has also advocated antitrust preemption of inefficient state laws, but his proposal adds the limiting criterion of "producer capture," by which he means successful producer lobbying efforts.¹⁵⁶ Wiley notes that consumers typically outnumber producers, but that legislation by which producers fleece consumers can arise anyway because a small group among whom a law concentrates benefits sometimes lobbies more effectively than a large group among whom the law disperses costs.¹⁵⁷ The reason is that each

154. See John Shepard Wiley, Jr., *A Capture Theory of Antitrust Federalism*, 99 HARV. L. REV. 713, 748-50 (1986) (noting the recent popularity in the Supreme Court of the Chicago School's pro-efficiency view of antitrust). While it is true that the higher prices charged by cartels and monopolies can result in allocative inefficiency, there is little evidence that Congress had in mind wealth creation per se—rather than preventing conduct that enriches large business combinations—when it passed the Sherman Act. See Lande, *supra* note 122, at 88 (noting that the concept of allocative efficiency would have been unknown to Congress in 1890). The pro-efficiency view of antitrust has nonetheless achieved prominence because the Act's legislative history suggests congressional solicitude for the interests of both consumers and small producers but does not recognize that these interests sometimes clash. Courts have therefore resorted to wealth maximization as a tiebreaker when contrary case outcomes both find support in congressional intent. But no plausible description of congressional purpose suggests that efficiency was a primary congressional concern and therefore can trump clear indications that Congress wished neither an invasive preemption doctrine nor to prohibit market arrangements that do not enrich producers.

155. See, e.g., Cirace, *supra* note 154, at 484 (building his proposal upon the observation that Lochnerism is, according to his read of *Parker*-line decisions, "alive, well, and traveling incognito in the narrow state action area").

156. Wiley, *supra* note 154, at 764-65 (advocating preemption where there is "direct evidence of decisive producer political activity"); accord David McGowan & Mark A. Lemley, *Antitrust Immunity: State Action and Federalism, Petitioning and the First Amendment*, 17 HARV. J.L. & PUB. POL'Y 293, 358 (1994) (advocating preemption on antitrust grounds when "a private actor is responsible for initiating or facilitating passage of the state law").

157. Wiley, *supra* note 154, at 723-24.

small-group member may gain more personally from supporting redistributive legislation than each large-group member loses from not bothering to oppose it.¹⁵⁸ Wiley argues that this difference in incentives leads to a “free-rider problem,” which is a “systematic reason” for “doubting the policy wisdom of the state . . . political process.”¹⁵⁹

Wiley does not allege or cite evidence that Congress intended the Sherman Act as a means for overcoming free-rider dynamics in state politics.¹⁶⁰ His proposal thus fails the threshold Supremacy Clause requirement that a state law be preempted only if it clashes with Congress’s statutory objectives. But even if courts were willing to use preemption doctrine as a blind for agendas other than Congress’s, Wiley’s is not an agenda they would likely pick. Wiley calls on courts to protect majorities from exploitation by minorities but not vice versa, in square contradiction of the traditional role courts see for themselves in our constitutional system.¹⁶¹ Also, judicial review of (otherwise legal) lobbying efforts carries the ugly insinuation that legislators cannot be trusted to exercise independent judgment: the model is of legislators as passive levers over which constituencies vie for control. Judges are unlikely to sanction that vision of government or to visit such an insult on their fellow lawmakers in the legislative branch.¹⁶²

A third reform proposal is found in a recent article by John Lopatka and William Page, who suggest that state laws should be deemed invalid only if they “amount to a violation of the substantive rules of antitrust.”¹⁶³ Their proposal is thus (in effect)¹⁶⁴ the literalist approach, which I have already noted

158. *Id.* at 724.

159. *Id.* at 768.

160. Wiley situates his capture approach not in congressional intent but rather in his perception that public choice theory induced the Supreme Court starting in the 1970s to become less deferential toward state laws than it had been in *Parker*. *Id.* at 719, 727.

161. Matthew Spitzer argues more generally that “[u]ntil Wiley proffers an appealing theory of democratic legitimacy that allows majorities to exploit minorities, his distinctions will remain unjustified.” Mathew L. Spitzer, *Antitrust Federalism and Rational Choice Political Economy: A Critique of Capture Theory*, 61 S. CAL. L. REV. 1293, 1312 (1988).

162. One could imagine the umbrage taken by lower courts—not to mention the damage to their legitimacy—if the Supreme Court were to evaluate their holdings not on the content of their opinions but rather on the identity of the lawyers who had argued for the winning side.

163. See Lopatka & Page, *supra* note 30, at 270.

164. The degree to which Lopatka and Page would see their proposal as “literalist” is unclear; they suggest later in their article that a state law to be invalid merely must encourage private conduct that is “closely analogous” to a Sherman Act violation. *Id.* at 287. I characterize their approach as literalist because of the results they advocate. For example, they would uphold a state law that protects a monopolist but does not regulate prices because such a law “has no counterpart in the law of exclusionary conduct developed under section 2.” *Id.* at 322. Similarly, they would uphold those state laws, resulting from the so-called Master Settlement Agreement, that seek to insulate tobacco producers from price competition. Although such laws enable producers to raise prices to non-competitive levels

excuses state schemes—such as those which protect but do not regulate monopolies—that directly undermine the purpose of the Sherman Act. Lopatka and Page acknowledge that state laws creating monopolies “may or may not be socially productive,”¹⁶⁵ but they argue that these and other laws involving no antitrust violation must be upheld anyway so that states are not “unduly constrained in their regulatory choices.”¹⁶⁶ I agree that the literalist approach is deferential to states in the sense that state lawmakers plainly have had little trouble thinking up devices other than outright Sherman Act violations to transfer wealth from consumers to producers. But I note that deference to state lawmakers is also built into the doctrine of implied exemptions, which permits states to encourage Sherman Act violations that make a valid state regulatory scheme cheaper to administer. And that doctrine fails by definition unless the validity of the regulatory scheme depends on something other than whether it encourages illegal conduct.¹⁶⁷ The literalist approach is thus a steep price to pay for deference to state law: not only does it offer less deference than meets the eye, but it also extends that deference to schemes which least deserve it—such as those that protect but do not regulate a monopoly, or that empower one firm to dictate the prices that competitors must charge.

I believe that tenable limiting criteria can be identified which, unlike the literalist approach, accord less deference to state regulatory choices as the degree of conflict with Congress’s antitrust objectives increases. I discuss these criteria next.

and thereby create the equivalent of a cartel, they would survive under Lopatka’s and Page’s approach because they do not cause producers to enter into agreements that would violate the Act’s section 1. *Id.* at 313-16. To the extent that, notwithstanding such results, Lopatka and Page would permit courts to invalidate state laws by “process of analogy,” *id.* at 298, their approach seems indeterminate in the same manner as Areeda and Hovenkamp’s “same marketplace result” test. *See supra* Part I.D.

165. *Id.* at 322.

166. *Id.* at 316.

167. Lopatka and Page would permit a state to encourage antitrust violations if the state actively supervises the violators; their reasoning is that only a state regime which encourages but does not supervise illegal conduct is a “naked repeal of antitrust,” meaning that the law “negates federal policy without substituting any coherent alternative policy.” *Id.* at 277. This argument seems to overlook that a state could view the higher prices resulting from a cartel as a kind of Pigovian tax aimed to reduce negative externalities of economic activity. A state could thus, for example, encourage horizontal price-fixing among manufacturers as a way of reducing output and thus noxious factory emissions. Nothing about a lack of active supervision in such a regime would undermine the connection between price-fixing and lower output or otherwise suggest that the state’s clean-air policy is not “coherent.” Indeed, Lopatka and Page acknowledge that a state may “sacrifice the interests of consumers in order to serve some interest it deems more important,” *id.*, but they do not address situations (as in my hypothetical) where such an interest is served by unsupervised antitrust violations.

C. Limiting Criteria that Vindicate Congressional Intent

Much of the apparent breadth of the valid preemption criteria I have identified—consumer harm and producer enrichment—arises because so far I have been relying upon two bright-line rules developed by judges to resolve difficult questions regarding the motives of market participants. One rule I have already mentioned: producers may restrain trade to benefit others only if the producers are not also thereby enriched. The other bright-line rule is that producers accused of fixing prices may not defend on grounds that the prices they fix are “reasonable” (or “fair”). Although these rules are sound as applied to market participants, they both reflect assumptions that are inaccurate if applied instead to state lawmakers. For this reason, both rules can be reconsidered in the preemption realm without undermining the antitrust purposes the rules vindicate in the conduct realm.

1. Laws with mixed beneficiaries

Most judge-made antitrust rules reflect a presumption that people act according to their self-interest. For example, courts presume that producers who restrict output do so to enrich themselves. Firms accused of violating the Sherman Act can rebut this presumption, but only by showing that they were not in fact enriched by their otherwise illegal conduct. As with any bright-line rule, this one is over-inclusive: there will be occasions when the motive of altruism is predominant and the fact of self-enrichment incidental. But the presumption of self-interest suggests that such occasions are rare and therefore that the avowed third-party benefits of self-enriching market conduct are likely to be pretext.

A different analysis applies, however, to lawmakers. Where a market participant sees a stranger, a lawmaker usually sees a constituent. This means that the self-interest of lawmakers to curry favor with multiple constituencies can explain the non-producer benefits of producer-enriching regulation, even while altruism and coincidence are the only reliable explanations for the third-party benefits of self-enriching market conduct. In preemption cases, then, courts can relax their bright-line rule regarding multi-beneficiary trade restraints without making heroic assumptions about the motives of lawmakers as contrasted with market participants.

The different incentives facing state lawmakers lower the pretext hazard but do not eliminate it. An increase in the price of any good will almost always be of some benefit, however attenuated, to a group other than the good's sellers. Thus, unless federal antitrust law is to lack preemptive force altogether, courts asked to evaluate producer-enriching laws need some means for determining whether non-producer benefits touted by lawmakers are little more than a legislative afterthought. One option would be for courts to try to identify

the dominant legislative motive by calculating whether the dollar value of the non-producer benefits that legislators attribute to higher prices—fewer negative externalities from production, keeping children from vice, and so on—exceeds the marginal increase in producer profits. But such calculations are likely to be both time-consuming and of dubious value, and not only because they are well outside the zone of judicial competence. The quantification of many social benefits is intrinsically imprecise, and will be a poor proxy for legislative motive anyway because redistributive policies usually presuppose that the social value of a dollar depends on who receives it.¹⁶⁸

Rather than try to quantify a regulation's impact, a better approach would be for courts to assess the significance of third-party benefits based on which market transactions the regulation prohibits. As I have noted, most mixed-beneficiary laws create entry barriers. And the non-producer beneficiaries of these laws are usually evident in the entry criteria: zoning codes, for example, typically cluster land uses in ways that bear a plausible relationship to the preservation of neighborhood property values. Similarly, officials who license attorneys do not issue bar admissions by lottery: they use competency tests, which plausibly reduce customer search costs and ostensibly foster the law's development through better trial advocacy. And advertising restrictions usually target media most visible to children, such as billboards near schools and broadcast television. Courts could therefore verify the validity of such laws simply by inspecting the statutory language and consequent regulatory structure.

It is true that the non-producer benefits of mixed-beneficiary laws may sometimes be slight, and also that the magnitude of such benefits may not always be obvious on mere inspection of the statutory language. But the pretext concern is counterbalanced by the fact that most entry-barrier laws do not raise prices in the manner ideally suited for enriching a given set of producers. In an open market, competition will cause firms to enter and exit until the cost of producing a given amount of output is minimized.¹⁶⁹ By contrast, laws that

168. *Accord* Posner, *supra* note 18, at 715 (arguing that “federal courts cannot weigh alleged benefits [of regulation] against a possible adverse impact on competition [because] the weighing does not lend itself to a logical or objective reasoning process”). In theory, courts could also abandon the traditional antitrust rule that equates motive with effect and instead search legislative history for evidence of regulatory purpose. But when a law reflects mixed legislative motives—as is likely whenever a law benefits multiple groups—committee reports may be a poor indicator of which motives predominated among legislators as a whole. What is worse, a preemption doctrine that turned on legislative history rather than statutory text could be evaded if legislators simply made exaggerated but otherwise non-binding professions of social purpose on the legislative record. By comparison, legislators cannot easily “game” a doctrine that equates legislative motive with legislation's economic impact.

169. The intuition is that firms will seize any opportunity to reduce costs because by doing so they increase their profits. In formal terms, firms enter and exit until price is equal to each firm's average total cost of production, which reflects both variable and fixed costs.

suppress the number of competing firms preclude production in the most cost-effective manner. This is because an individual firm's marginal cost of production tends to rise with each unit produced; a law that decreases the number of firms will therefore increase the overall cost of producing a given amount of output.¹⁷⁰ Moreover, firms will voluntarily incur higher marginal costs (by expanding output) only if paid to do so, which is why entry-barrier laws lead to higher prices. To be sure, producers not excluded by the entry barrier will be enriched: each will be selling more units and at a higher price.¹⁷¹ But, importantly, the typical entry-barrier law does not reduce the number of firms to the point that firms can further enrich themselves by exercising market power—that is, by raising prices above their own marginal costs without fear of being undersold. States with professional licensing requirements still have thousands of doctors and lawyers, cities with zoning restrictions still have dozens of retailers, and so on. Thus, if a state's primary goal were to enrich a particular group of producers, and especially if the state were indifferent to the degree of injury to consumers, the typical entry-barrier law is not the mechanism the state would most likely choose.

The contrast, then, is state laws that constrict output not (only) by increasing production costs, but rather (or also) by suspending price competition. These laws fall into two types, corresponding to the Act's two main sections. Laws in conflict with section 1 create a cartel—that is, they permit multiple producers to sell in a market but they suspend price competition among them. An example of this type is an across-the-board advertising ban,¹⁷² or a statutory mechanism that empowers one firm to dictate prices that its competitors must charge.¹⁷³ Laws that conflict with section 2 suspend price competition by creating a monopoly. For example, a state could issue an express monopoly license, or it could raise entry barriers high enough

Prices above that level mean that firms can profit by entering; prices below mean that firms can avoid losses only by exiting. For a fuller discussion with diagrams, see SULLIVAN & HOVENKAMP, *supra* note 103, at 51-54.

170. *Id.* at 46-48. Strictly speaking, a decrease in the number of firms only increases the *variable* cost of producing a given level of output; *fixed* costs will (by definition) be lower. But if the entry-barrier law leads to fewer firms than would otherwise compete, then the increase in variable costs will exceed the reduction in fixed costs; otherwise, the pursuit of profit alone would have caused some firms to exit.

171. This is true unless the barrier itself consists entirely of an increase in costs, such as a tax, in which case the law would be valid under my approach by virtue of not enriching producers. Also, it should be noted that an entry barrier will drive down overall market output even as it increases output on a per-firm basis. This is because an increase in price will reduce the number of units that consumers are willing to buy.

172. See *Bates v. State Bar of Ariz.*, 433 U.S. 350, 368-69 (1977) (analyzing a claim that a ban on attorney advertising was justified because pricing competition might cause attorneys to economize on the quality of services they provide).

173. The nonsigner provisions of the laws at issue in *Schwegmann*, discussed *supra* note 30, probably suspended pricing competition in this manner.

to leave an incumbent firm with monopoly power—generally defined by courts as at least a 50% market share.¹⁷⁴ Because laws that create cartels and monopolies enable firms to raise prices above their own marginal costs, they decrease output not only market-wide but also on a per-firm basis, and thus lead to heightened levels of both consumer injury and producer enrichment. As a categorical matter, such laws create a degree of conflict with federal antitrust objectives not present when firms, even if made fewer by entry barriers, still face competition that drives prices down to the level of marginal production costs. Such laws, in other words, are those for which the damage to federal antitrust policy is greatest if a court fails to recognize the pretextual nature of any third-party benefits touted by the state. To ensure vindication of core antitrust objectives, courts must therefore subject such laws to scrutiny more probing than a mere textual search for non-producer beneficiaries.

A small number of monopoly-creating state laws could escape preemption on the alternative ground that they reward beneficial innovation. The monopolies created by such laws presumably would have to resemble federal patent licenses in their being tied to a specified technology or production method. But state regimes of this type are rare precisely because federal patent law normally preempts them.¹⁷⁵ State laws creating monopolies are far more likely to take the form of traditional public utility regimes, exclusive grants of access to government property such as those seen in *Arsberry*, or stringent zoning codes that leave retailers without local competition. And state laws that suspend pricing competition among multiple producers (instead of creating a monopoly) almost never do so to reward innovation. For these reasons, laws that suspend pricing competition should normally escape preemption only if valid under my second proposed limiting criterion, to which I now turn.

2. Laws that pursue “fair” or “reasonable” prices: A public cost theory of active supervision

When governments suspend price competition, they often cite a public need for “fair” or “reasonable” prices.¹⁷⁶ For example, state wage and hour laws ensure—according to statutory definitions—pay that is “fairly and reasonably commensurate with the value of the service . . . rendered.”¹⁷⁷ The city council from *City of Berkeley*, in turn, explained that its rent control

174. See AREEDA ET AL., *supra* note 2, ¶ 365c n.9, at 532.

175. See, e.g., *Sears, Roebuck & Co. v. Stiffel Co.*, 376 U.S. 225 (1964) (holding that a state may not use its law of unfair competition to forbid a firm from copying a product not eligible for a federal patent).

176. An exception is the across-the-board advertising restriction in *Bates*, which the state attempted to justify in terms of consumer welfare. See *supra* note 172.

177. ARIZ. REV. STAT. § 23-311(5) (2006); accord CONN. GEN. STAT. § 31-58(c) (2006).

regime prevented rent increases, not in all circumstances, but only when “unwarranted.”¹⁷⁸ And in *Parker* the Supreme Court joined in the act, explaining that California had enacted the raisin regime to ensure farmers a “fair return” on raisin sales, “without permitting unreasonable profits.”¹⁷⁹ Although such explanations are inherently vague, they at a minimum imply a price-selection method that gives independent weight to the interests of both sides to the regulated transaction. The contrast is the method by which self-interested market participants select price and output levels: a profit-maximizing monopolist, for example, values the interests of buyers not for their own sake, but only to the extent that they constrain the monopolist’s ability to profit from price increases due to the inverse relationship between price and quantity demanded.

At least under the antitrust rules normally applied to market participants, all state laws that harm consumers merely so that producers may charge “reasonable” or “fair” prices would be forbidden. Although the Supreme Court has read a “rule of reason” into the Sherman Act,¹⁸⁰ judges have consistently closed their ears to the defense that a producer’s output-constricting conduct raised prices only to a “fair” or “reasonable” level.¹⁸¹ This bright-line rule, like the one against mixed-beneficiary trade restraints, reflects the presumption of self-interest as applied to market participants, which renders negligible the possibility that a producer will exercise market power only to take “reasonable” rather than maximal profits.¹⁸² And, once again, the presumption of self-interest implies a different rule for the preemption context: state lawmakers, even if they wish to readjust prices in favor of one side to a transaction, usually face political incentives not to disregard the interests of the other side altogether.¹⁸³

178. *Fisher v. City of Berkeley*, 475 U.S. 260, 262 (1986) (internal quotation marks omitted).

179. *Parker v. Brown*, 317 U.S. 341, 355, 364 (1943).

180. *Standard Oil Co. v. United States*, 221 U.S. 1, 66 (1911).

181. *United States v. Trans-Missouri*, 166 U.S. 290, 339 (1897) (rejecting antitrust defense based on the reasonableness of prices); *see also Atl. Richfield. Co. v. USA Petroleum Co.*, 495 U.S. 328, 353 (1990) (“If any proposition is firmly settled in the law of antitrust, it is the rule that the reasonableness of the particular price agreed upon by defendants does not constitute a defense to a price-fixing charge.”).

182. A second consideration is that Congress in neither the text nor legislative history of the Act provided courts with a definition of a reasonable price level—that is, a sense of how much consumer welfare producers may sacrifice when they deviate from the competitive price level.

183. The primary exception is where one side to the transaction is not a state lawmaker’s constituent, for example if that party resides in another state. In that case, the lawmaker’s self-interest will entirely coincide with the interests of only one side to the transaction, making “fair” prices a far less likely regulatory outcome. Fortunately, the Supreme Court sometimes interprets the dormant commerce clause to prohibit laws that protect in-state producers at the expense of out-of-state consumers. *See, e.g., Pike v. Bruce Church, Inc.*, 397 U.S. 137 (1970) (holding that Arizona could not impose an in-state

There is, admittedly, an additional reason for the bright-line rule against the reasonable-prices defense, which this time does not depend on the presumption of self-interest. Under the modern, pro-consumer view of antitrust (as contrasted with the small-is-beautiful view), producers would *never* be allowed to enrich themselves at the expense of long-term consumer interests, even if those producers could somehow rebut the presumption that they had failed to give consumer interests independent weight when selecting the price level. If the Sherman Act must similarly be read to disallow any state-ordered wealth transfer from consumers to producers, the greater likelihood that states would determine the amount of that transfer in a “fair” or “reasonable” manner is irrelevant. There are two good reasons, however, to reject this implication of the pro-consumer view of antitrust as applied to state law. One is the mandate of deference in the preemption realm: the sheer number of state laws that suspend price competition in order to enrich producers suggests that at least some must be permitted. The second reason is the general repudiation of *Lochner*, a case in which the Court struck down a state regime that, by capping hours worked in bakeries, would have harmed consumers for the sole purpose of enriching producers. A categorical Sherman Act prohibition on state regulation that redistributes wealth in favor of producers would seem little more than *Lochnerism* redux, and would thus be a political nonstarter.

For these reasons, the better approach is to give states some latitude to do what market participants may not: enrich producers by raising prices, as long as consumer interests enjoy independent weight in the price-selection method. Of course, judges cannot wholly defer to avowals that state lawmakers have weighed consumer interests in their decision to raise market prices, for then antitrust preemption would be an impediment only to those lawmakers artless enough to be honest about their intentions. The fact that buyers are also political constituents makes their importance to state lawmakers plausible but not inevitable. The question, then, is whether there is a reliable way for judges to assess the credibility of a state’s claim that it has displaced competition to achieve “fair” prices, as contrasted with prices aimed to maximize producer profits.

Besides their putative justification in terms of fair prices, another common feature of wage-and-hour, rent-control, and agriculture-support laws is state control over price and output levels. For example, legislatures typically set minimum-wage and maximum-hour levels directly by statute, and they appoint panels of public officials to specify rent levels or (as in *Parker*) the volume of agricultural products released to market. State pricing control is notable because it would typically vindicate such arrangements under the state-action immunity doctrine’s active supervision requirement. According to my analysis here, such results are justified if there is reason to believe that state pricing

processing requirement on cantaloupe growers that might benefit some growers but increase the costs of exporting cantaloupes to out-of-state buyers).

control evinces a regulatory intention to achieve “fair” rather than monopoly-level prices.

Unfortunately, the Supreme Court has not been able to identify a coherent function for active supervision in the preemption context. In an implied exemption case, the Court usefully explained that active supervision prevents the state-action immunity doctrine from becoming “an attractive nuisance in the economic sphere.”¹⁸⁴ This image vividly depicts why courts need tools to confirm that an antitrust defendant’s conduct in fact advanced the state regime under which the defendant seeks an exemption. But in preemption cases—where the question is not whether a defendant’s conduct advanced a state regime, but whether a state regime is enforceable—the Court relies on *Midcal*’s “gauzy cloak” image, or (as in *City of Berkeley*) relabels active supervision through the unilateral-hybrid distinction, under which a *lack* of state supervision somehow becomes the *presence* of public-private collusion in violation of section 1. A natural consequence is that the Court’s definition of active supervision in preemption cases has been erratic. For example, in *Midcal* the Court defined active supervision to mean state control over pricing. But in *Bates v. State Bar*, the Court held that a state ban on attorney advertising satisfied active supervision—even though the state did not regulate prices—merely because the state supreme court enjoyed power to enforce the ban.¹⁸⁵ Of course, it is hard to imagine a state regulatory scheme that state courts will lack jurisdiction to enforce.

Although active supervision has drawn more scholarly attention than has the violation requirement, previous commentators also have not shown how active supervision evinces that a state’s regulatory goals do not conflict with the purpose of the Sherman Act. Einer Elhauge, for example, has argued that the Sherman Act reflects Congress’s conclusion “that those with financial interests in restraining competition cannot be trusted to determine which restraints are in the public interest.”¹⁸⁶ Under this theory of congressional intent, which Elhauge calls a “process” view, active supervision ensures that a financially disinterested—and hence trustworthy—state legislature cannot delegate its regulatory powers to financially interested market participants.¹⁸⁷ As I have made clear, I agree with Elhauge that many antitrust rules reflect a presumption (be it congressional or judicial) that market participants will tend to pursue their financial self-interest. But I disagree that active supervision

184. *FTC v. Tigor Title Ins. Co.*, 504 U.S. 621, 637 (1992).

185. *Bates v. State Bar of Arizona*, 433 U.S. 350, 360-62 (1977).

186. Elhauge, *supra* note 71, at 683.

187. *Id.* at 708. Steven Semeraro has similarly argued that active supervision ensures that “a potentially anticompetitive decision” is immunized only if it “furthered a presumptively altruistic state actor’s view of the public interest, rather than the interests of presumptively selfish private actors.” Steven Semeraro, *Demystifying Antitrust State Action Doctrine*, 24 HARV. J.L. & PUB. POL’Y 203, 226 (2000).

distinguishes valid state regimes if one adopts Elhauge's additional premise that financially disinterested decisions are inherently legitimate. Disinterested state legislators could, for example, conclude that enriching a group of firms would advance the public interest and that permitting those firms to fix prices is the most expedient way to enrich them. According to Elhauge's description of congressional intent this regulatory decision is valid: the cartelized firms are not being "trusted to determine which restraints are in the public interest"; they are merely being trusted to follow their self-interest, which the legislature has decided coincides with the interests of the state generally. But the regime would fail the active supervision requirement because the firms' price-setting decisions are unsupervised.¹⁸⁸

Elhauge's response to a hypothetical put to him by Frank Michelman hints at a better explanation for active supervision. A state legislature decides that whatever is good for General Motors is good for the state as a whole, and thus empowers a public official to set auto prices at levels that maximize GM's profits.¹⁸⁹ Because a financially disinterested official sets the prices, this regime is valid according to Elhauge's "process" view, under which the legitimacy of state law inheres in the personal financial interests of the decision-maker. But instead of reaching this conclusion, Elhauge instead condemns the GM regime for "regulat[ing] on the premise, rejected by Congress, that setting restraints to further the financial interests of market participants is likely to advance the public interest."¹⁹⁰ As will become clear, I agree with Elhauge here that what really matters is the economic outcome that

188. Elhauge might argue that my hypothetical still involves some "delegation" regarding the level of restraint; the private firms empowered to form a cartel could, contrary to the antitrust presumption of self-interest, undermine the state's regulatory objective by refusing to set prices at the level that maximizes their own profits. Of course, if the firms are corporations, the fiduciary duties of the corporate officers *compel* the pursuit of financial self-interest. But the more important point is that any regulatory regime—even one featuring active supervision by financially disinterested public officials—presumes that market participants will follow their self-interest. For example, the raisin regime in *Parker* displayed active supervision and yet its objective to enrich raisin growers presupposed that raisin buyers would continue to purchase raisins at higher prices when it benefited them to do so. The possibility that raisin buyers might react spitefully by refusing to buy any raisins at all, a move contrary to their own financial interests as well as those of growers, did not render the regime invalid due to excessive "delegation" to market participants.

189. Elhauge, *supra* note 71, at 710.

190. *Id.* Elhauge questions whether the public official in this hypothetical actually is financially disinterested; Elhauge observes that the official "has no personal financial interest but is clearly acting in a financially interested capacity: in fact, he occupies almost the exact same position as a General Motors employee." *Id.* But of course a GM employee has a personal financial stake in GM, while the hypothetical public official—as Elhauge acknowledges—does not. What the official and employee do have in common is a task to enrich GM; if this is what Elhauge means by a "financially interested capacity" he seems to be saying that the validity of a regime turns on the actual regulatory objectives chosen and pursued by decision-makers rather than their personal financial interests.

a state actually pursues, rather than—as Elhauge’s “process” view would seemingly have it—the financial interests of the agents through whom the state pursues that outcome. In other words, the fatal flaw in the hypothetical state scheme is its goal to maximize GM’s profits, and this goal would doom the scheme regardless of whether those who created or implemented the scheme stood to profit from doing so. But I note that Elhauge’s description of the impermissible economic outcome is overbroad: the regimes in both *Parker* and *City of Berkeley* involved pricing and output decisions actively supervised by public officials, and yet the clear purpose of both was to “further the financial interests of market participants” (that is, to enrich them). What is needed is both a finer description of the forbidden regulatory objective and a reason to think that a lack of active supervision evinces it.¹⁹¹

I have already suggested a more precise description of the economic outcome that states may not pursue: states may not try to enrich producers by raising prices to monopoly (that is, profit-maximizing) levels, even though states may pursue “fair” or “reasonable” prices. But the question remains whether state pricing control is reliable evidence that a regulatory scheme is meant to achieve “fair” price and output levels. I believe that the answer in most cases is yes, because a state by seizing control of market prices incurs costs—which I call “public costs”—that the state could easily avoid if its purpose were to enrich producers without regard to the interests of consumers. The state’s willingness to bear such public costs therefore provides reliable evidence that the state’s aim is to set prices at something other than the monopoly level.

The most obvious of these public costs is pricing distortion. A market participant is almost always better situated than an independent public official to know which price level maximizes the participant’s profits. To revisit an example, if a state’s sole objective were to maximize GM’s profits, the state could simply issue a monopoly license and then get out of the way. Self-

191. Page and Lopatka have also offered an explanation for active supervision in the preemption context. To them, the *Parker* doctrine signifies that states may not displace competition merely to advance “the private interest of a particular party.” William H. Page & John E. Lopatka, *State Regulation in the Shadow of Antitrust: FTC v. Ticor Title Insurance Co.*, 3 SUP. CT. ECON. REV. 189, 212 (1993). States instead must announce and then pursue some “criterion of the public interest,” and active supervision ensures that this criterion is not “a disguise or sham.” *Id.* The authors do not, however, explain why active supervision is superior to other means for enforcing a statutory criterion (such as a private right of action), nor do they explain why the court hearing the preemption challenge cannot assess directly whether a state regime is in fact serving its alleged purpose, making active supervisors unnecessary. Finally, the authors do not explain why active supervisors ensure a regulatory objective’s vindication: just because supervisors are active does not mean they are actively advancing a criterion listed in a statute. Although Page and Lopatka note that the statutory criterion provides a standard by which state judges and other state officials can discipline the active supervisors, *id.* at 214, this observation merely shifts the question of motivation to other state actors but does not answer it.

interest would take care of the rest: GM's managers would set prices at the profit-maximizing level, and the managers' intimate knowledge of market conditions would allow them to do so quickly and accurately. Indeed, states follow precisely this formula when they permit workers to form unions, which for this reason have required a specific antitrust statutory exemption.¹⁹² The public cost of pricing distortion is magnified by the fact that a price-setting public official who is truly active (rather than just a rubber stamp) would not only add little in terms of useful market knowledge; the official would actually retard the price-adjustment process, a problem because a monopolist no less than a competitive firm faces fluctuating demand and cost conditions which require prompt responses to maintain profit maximization.¹⁹³

A second public cost is that public officials with price-setting authority must be paid. This cost may seem trivial in a regime such as the GM hypothetical, which assumes only one price-setting public official. But that is only because the notion that one person could set profit-maximizing prices for GM is highly unrealistic. GM sells dozens of car, minivan, SUV, and truck models, each with scores of options and financing plans. Moreover, it sells these products not in a single worldwide market, but rather in hundreds of regional markets across every inhabited continent, each with its own cost and demand conditions. A single public official charged with identifying the profit-maximizing price for each combination of these factors would face information costs of the magnitude that bedeviled Soviet central planners, and thus would almost certainly fall well short of the goal of profit maximization. Pricing distortion perhaps could be reduced by increasing the number of officials assigned the task, though the army that would likely be needed to make the full range of GM pricing decisions in an informed and speedy manner would send the administrative costs of the regime skyrocketing.

A final public cost is that the direct involvement of public officials in pricing decisions increases the visibility, and thus potential political fallout, of the state's role in harming consumers to enrich favored producers.¹⁹⁴ Staying

192. See Clayton Act, 15 U.S.C. § 17 (2006).

193. Along these lines, Keith Hylton has noted that the active supervision requirement results in "heavy-handed regulation" which blunts the incentive for private firms to lobby for state-authorized price fixing. KEITH N. HYLTON, *ANTITRUST LAW: ECONOMIC THEORY AND COMMON LAW EVOLUTION* 374 (2003).

194. The Supreme Court has noted that active supervision promotes political accountability in implied exemption cases by making salient a state's decision to permit market participants to engage in Sherman Act violations. *FTC v. Ticor Title Ins. Co.*, 504 U.S. 621, 636 (1992). My related point is that a state's willingness to make visible its responsibility for a particular market outcome is useful evidence in a preemption case of the state's underlying regulatory purpose.

Also, Robert Inman and Daniel Rubinfeld have argued that active supervision promotes "citizen political participation" by assuring "the original [political] participants that their initial bargain will be enforced." Robert P. Inman & Daniel L. Rubinfeld, *Making Sense of the Antitrust State-Action Doctrine: Balancing Political Participation and Economic*

with the GM hypothetical, the state's conspicuous complicity in a scheme designed to maximize one firm's profits would invite political backlash from GM's rivals and consumers. Creating a cartel rather than a monopoly might buy off the rivals, but this would only further multiply the factors relevant to optimal pricing, thereby driving up administrative costs and the risk of pricing distortions. As is evident, there are trade-offs among the three public costs of pricing distortion, administrative burden, and constituency protest. But, at least in the GM hypothetical, there is no plausible regulatory structure under which the sum of these costs is insignificant.

The public cost theory therefore suggests that the better response to the GM hypothetical is simply to note that it is too implausible to cast doubt on the usefulness of an active supervision requirement. The state in the hypothetical could avoid an array of costs associated with pricing control if its goal were to maximize GM's profits. Thus, if the state really were to seize pricing control, the far more likely reason would be that the state's regulatory purpose is to set prices in a manner that gives independent weight to the interests of car buyers. Of course, if the state lawmakers were guileless enough to admit (for example in a statutory preamble) that their goal really was to maximize GM's profits, an investigation into the presence of active supervision would be unnecessary because the regulatory purpose would be uncontested. This possibility marks a practical difference between Elhauge's approach, under which the identity of decision-makers is an end in itself, and my own, under which the identity of decision-makers is a source of rebuttable evidence about a state's underlying regulatory objectives.

The sum of public costs may admittedly be lower if the regulated product involves less pricing complexity than do cars and trucks and the group being enriched is more politically sympathetic than a large manufacturer. As with many evidentiary standards, state pricing control will be under-inclusive,¹⁹⁵ and will sometimes be found in regimes that, despite the public costs I have

Efficiency in Regulatory Federalism, 75 TEX. L. REV. 1203, 1212, 1257 (1997). These authors do not, however, argue that Congress in enacting the Sherman Act intended to get citizens more involved in state politics, and so they do not provide a reason that such participation is a relevant value in an antitrust preemption doctrine. (The authors also do not explain why courts should insist on active supervision rather than other means for enforcing political bargains, such as private lawsuits against parties whose actions fail to vindicate regulatory objectives.) But their focus on political participation is nonetheless relevant in the sense that the likelihood of a group's participation in politics provides evidence that state lawmakers considered that group's interests in the lawmaking process.

195. Over-inclusiveness is also a hazard: a decision-making formula that gives independent weight to the interests of both sides to a transaction might, depending on the weights assigned to the interests of each side, still end up selecting the monopoly price. In that case, a supervision requirement would impose costs on the state unnecessary to the achievement of the "fair" price. But this should be unproblematic to the extent that the exact confluence of the "fair" and the profit-maximizing price is an unlikely coincidence, which one need not be unusually cynical about politics to suspect.

identified, really do seek to maximize producer profits. The GM hypothetical (without the guileless statutory preamble) illustrates this possibility, though I have already noted why the hypothetical is implausible. A better illustration of the hazard of under-inclusiveness comes from *Parker* itself: farmers seem to be more politically sympathetic than most other economic producers, and the pricing of a commodity such as raisins is less complex and therefore less susceptible to distortion by state supervisors than the pricing of motor vehicles.¹⁹⁶ Nevertheless, at least in cases where the state does not confess that its goal is to confer monopoly profits on producers, state pricing control seems more attractive than other possible gauges of regulatory intent. Courts cannot simply assume that state lawmakers (even if financially disinterested) will always value the interests of both sides to a market transaction, for otherwise every law they enacted would presumably produce “fair” prices, and the Sherman Act would lack preemptive force altogether. Nor are courts competent to calculate for themselves whether a price level adheres to a given definition of a “fair” price or is instead closer to the level that maximizes producer profits.¹⁹⁷ State pricing control will tend to move prices away from the monopoly level precisely because price-setting public officials face high information costs, and there is no reason to think that judges are better equipped than administrative officials to sift through the relevant data and seize upon the profit-maximizing price.

An implication of the public cost theory is that active supervision should be defined more strictly when used to answer questions of preemption rather than implied exemption. The public costs I have identified arise only when price-setting officials exercise independent control: mere authorization of prices suggested by market participants will not do. But the independence of state supervisors is less critical in the implied exemption context, where there are many evidentiary sources (including statutory language) that a court could use to verify that a defendant’s conduct advanced a particular state regime. Hence *Town of Hallie*, where the Supreme Court was willing to recognize an implied exemption despite a lack of active supervision because the validity of the underlying state regime was not in question and the connection between that regime and the defendant’s conduct was obvious.¹⁹⁸ The contrast is *FTC v. Titor Title*, a case in which the Court insisted upon the presence of highly active state supervisors.¹⁹⁹ *Titor* was nominally an implied exemption case; it

196. A third under-inclusiveness hazard in *Parker* came from the fact that most buyers of California raisins lived outside the state, *Parker v. Brown*, 317 U.S. 341, 345 (1943), and state officials would therefore have had no incentive to consider the interests of such buyers in the setting of “fair” price and output levels.

197. See *Blue Cross & Blue Shield United v. Marshfield Clinic*, 65 F.3d 1406, 1412 (7th Cir. 1995) (detailing practical difficulties with a judicial determination that a firm has set prices at monopoly levels).

198. *Town of Hallie v. City of Eau Claire*, 471 U.S. 34, 44 (1985).

199. *FTC v. Titor Title Ins. Co.*, 504 U.S. 621, 637-38 (1992).

involved defendants who argued that their otherwise illegal conduct advanced valid state regulatory schemes.²⁰⁰ But these state schemes authorized horizontal price-fixing and thus presented a heightened degree of potential conflict with federal antitrust policy.²⁰¹ By insisting upon state pricing control, the Court therefore made sure the state regimes were valid and thus capable of supporting implied exemptions for the defendants' conduct. The implication, of course, is that "active supervision" is really two doctrinal tests requiring two different levels of scrutiny, depending on whether the question is the state's underlying purpose in regulating (the preemption question) or the types of market conduct that further that purpose (the implied exemption question). The conflation of these separate tests under the common label "active supervision" is another regrettable consequence of the Court's failure to break out antitrust preemption as a distinct category of case.

In summary, my proposed doctrine would generally permit a state to suspend price competition in order to enrich producers only if the state then steps in to determine and dictate price or output levels. I next use specific cases to illustrate the practical differences between the Court's preemption approach and my own.

D. Antitrust Preemption Applied

My proposed doctrine breaks state laws into three groups, and I will use that structure to organize my review of my proposal as applied in particular cases. The first group contains laws that do not transfer wealth from consumers to producers; these would be valid under my approach as a categorical matter. Next come laws that do transfer wealth from consumers to producers but in a way that preserves pricing competition, by which I mean that the laws do not prevent or discourage competitors from undercutting a producer who raises prices above that producer's own marginal costs of production. These laws would be valid if a deferential review of the enacting statute and regulatory structure confirms that the regime likely benefits non-producers or pursues "fair" prices. The final group contains laws that enrich producers by creating a monopoly or otherwise suspending price competition within a particular set of producers; these would be preempted unless the state steps in and sets the prices.²⁰²

200. *Id.* at 625. The technical allegations in *Ticor* were of violations of section 5(a)(1) of the Federal Trade Commission Act, but the Court deemed the distinction between that provision and section 1 of the Sherman Act irrelevant for state-action immunity purposes. *Id.* at 625, 635.

201. *Id.* at 628.

202. Laws in my third group would also escape preemption if they suspend competition to reward innovation beneficial to consumers.

Hertz and *City of Berkeley* involved state laws in my first group. I have already noted how the courts in *Hertz* had great difficulty deciding whether an ordinance banning residence-based pricing by car rental companies “violated” the Act’s section 1, but ultimately concluded, after surveying various social interests, that the ordinance was preempted. Under my approach, the challenge could have been dismissed on grounds that an ordinance prohibiting variable pricing by producers is plainly not intended to enrich them. The Supreme Court similarly could have observed that the *City of Berkeley* rent control ordinance was designed to enrich consumers (tenants) rather than producers (landlords), and thus the Court could have achieved its desired result without resort to the unilateral-hybrid framework.

The state regime in *Midcal*, which enabled resale price maintenance by fiat rather than agreement, also falls into this first group. The Court struck down the *Midcal* regime by citing *Dr. Miles*,²⁰³ a 1911 case in which the Court held that resale price-maintenance agreements are per se violations of the Act’s section 1 because they “achieve the same result” as horizontal price-fixing.²⁰⁴ Since *Dr. Miles*, economists have noted that resale price maintenance rarely facilitates a cartel, and in most cases actually benefits consumers.²⁰⁵ The Court accordingly has pared down *Dr. Miles* by removing from the category of per se illegality many forms of resale price maintenance, including price maintenance imposed by a manufacturer in the absence of an agreement,²⁰⁶ agreements to maintain maximum (rather than minimum) resale prices,²⁰⁷ and a supplier’s assent to one retailer’s demand that another retailer be cut off.²⁰⁸ But the Court in *Midcal* inexplicably ignored the erosion under *Dr. Miles* and, despite the fact that the state regime did not involve illegal agreements, condemned the regime as a “violation” of the Act.²⁰⁹ Under my approach the only question in *Midcal* would have been whether the type of resale price maintenance authorized by the state would have suspended horizontal price competition in a way that harmed consumers. Since there was no evidence of such in the case,²¹⁰ the regime would have been deemed valid.

203. *Cal. Retail Liquor Dealers Ass’n v. Midcal Aluminum, Inc.*, 445 U.S. 97, 102 (1980) (citing *Dr. Miles Medical Co. v. John D. Park & Sons*, 220 U.S. 373 (1911)).

204. *Dr. Miles*, 220 U.S. at 408.

205. See SULLIVAN & HOVENKAMP, *supra* note 103, at 436-39; see also AREEDA ET AL., *supra* note 2, ¶¶ 404-06, at 537-39.

206. *United States v. Colgate & Co.*, 250 U.S. 300, 307 (1919).

207. *State Oil Co. v. Khan*, 522 U.S. 3 (1997).

208. *Business Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717 (1988).

209. *Midcal*, 445 U.S. at 103.

210. Indeed, the absence of an agreement in *Midcal* is evidence that the type of resale price maintenance fostered by the state regime was especially unlikely to promote horizontal price-fixing at the resale level. See SULLIVAN & HOVENKAMP, *supra* note 103, at 455-56.

A final example of a state regime in my first group comes from *Endsley*, the case in which a city operated a busy toll road.²¹¹ As an initial matter, I emphasize the irrelevance under my analysis of the fact that the case involved a regime at the municipal rather than state level. I thus avoid the pitfall whereby *Town of Hallie* is misread to require that states and municipalities be treated differently for preemption purposes.²¹² Turning to the specific facts of *Endsley*, an issue in the case was whether the plaintiffs had shown that the city-run toll road enjoyed monopoly power in a properly defined market.²¹³ Such a showing would be necessary under my preemption approach, wherein a state law conflicts with section 2 only if it actually produces a monopoly. But, importantly, the showing of a monopoly would not have been sufficient. Just because a state entity owns a monopoly does not mean that state law *caused* the monopoly; a state could instead happen to own a natural monopoly, which will arise when one firm can produce most cheaply the full quantity of output demanded by consumers. To win a preemption claim under my approach, the *Endsley* plaintiffs therefore would have had to show that city law excluded other viable transportation providers, for example by blocking private road construction, train services, and so on. The evidence in the case suggests otherwise.²¹⁴ Because the claims in *Endsley* therefore implicated no state law that transferred wealth from consumers to producers, the case would not have resulted in a finding of preemption under my proposed approach.

Unlike the regimes just reviewed, state laws in my second group do transfer wealth from consumers to producers by raising prices, but not in a manner that suspends price competition and thereby allows producers to raise prices above their own marginal costs. Most zoning schemes are of this type, as are professional licensing requirements. The Court analyzed a licensing scheme in *Hoover v. Ronwin*, a case brought by a would-be lawyer who had failed the Arizona bar exam.²¹⁵ The defendants in the case were state bar examiners, and the Court ruled for them by repeating *Parker's* dictum that a state and its

211. *Endsley v. City of Chicago*, 230 F.3d 276 (7th Cir. 2000).

212. *See supra* note 61.

213. *Endsley*, 230 F.3d at 282.

214. *See id.* at 283 (noting that the city permitted two other routes that were alternatives to the toll road). The city's toll road operation might also seem to have been beyond preemption under my proposal because the city itself—a public entity—set the tolls. But the city was acting as a market participant and therefore would have been ideally situated to set prices at the level that maximized its own profits. In other words, the public cost of pricing distortion is less likely to arise when the price-setting state entity is the market participant. On the other hand, constituency protest should still occur, and administrative costs may be higher than if the state conferred a monopoly on a private firm but then took a cut of the profits. For these reasons, state pricing control provides some evidence of a state's regulatory objectives when a state entity is the market participant, though less than when the state instead regulates prices charged by private firms.

215. 466 U.S. 558, 560 (1984).

officers do not violate the Sherman Act by enacting or enforcing regulation.²¹⁶ Though the Court was surely correct that the bar examiners had not violated the Act, by resting on these grounds the Court ignored the more relevant question, which was whether the state licensing regime was itself unenforceable. Although the licensing regime enriched lawyers by restricting entry, nothing in the case suggested that lawyers were thereby rendered so scarce in Arizona that they could exercise market power—that is, set fees based only on a client’s willingness to pay and without regard to the fees charged by other lawyers. Therefore, according to my approach the regime would only have had to survive a deferential review under which a court would verify consistency between its facial characteristics and any non-producer benefits touted by the state. And the regime would have passed: the standard justification of attorney licensing is the public interest in enhancing law’s administration and development²¹⁷—an objective plausibly related to the entry criterion of competence as measured by the bar exam.

The Supreme Court also considered state regulation of attorneys in *Bates v. State Bar*,²¹⁸ but this time reached a decision contrary to the one my approach would require. The case involved an antitrust preemption challenge to a disciplinary rule that banned advertising by attorneys. Per its normal practice, the Court mischaracterized the claim as alleging a “violation” of the Sherman Act;²¹⁹ it then upheld the ban on a finding that the state supreme court’s power to enforce the ban satisfied active supervision.²²⁰ Under my approach the relevant aspect of the advertising ban was its across-the-board nature, which suggested an intention to suspend price competition among practicing lawyers,²²¹ an objective that the state effectively conceded.²²² Because the state suspended price competition but did not step in to set prices, the regime would be invalid under my approach.

Other laws that effectively create a cartel—and thus like the *Bates* regime fall into my third group—have resulted from the tobacco industry’s so-called Master Settlement Agreement. Under that agreement the nation’s largest

216. *Id.* at 567-68.

217. *Id.* at 569 n.18.

218. *Bates v. State Bar of Arizona*, 433 U.S. 350 (1977).

219. *Id.* at 356-57.

220. *Id.* at 360. The Court’s cursory analysis of the active supervision requirement may be explained by the fact that the Court condemned the advertising ban on the alternative grounds that it infringed the right to free speech. *Id.* at 384.

221. *Cf. Va. State Bd. of Pharmacy v. Va. Citizens Consumer Council, Inc.*, 425 U.S. 748, 766-68 (1976) (noting that the purpose of an outright ban on price advertising by pharmacists was to prevent price competition and discourage consumers from price-shopping).

222. Specifically, the state argued that the purpose of the advertising ban was to protect lawyers from the “hustle of the marketplace” and from public perceptions that they are “motivated by profit.” *Bates*, 433 U.S. at 368. Of course, lawyers “hustle” and reveal a profit motive by competing with each other.

cigarette manufacturers settled various lawsuits by promising to make annual payments to forty-six states.²²³ The agreement also requires each manufacturer to pay more if its market share increases, thereby discouraging the companies from competing with each other on price.²²⁴ Finally, the agreement encourages states to enact statutes that impose financial penalties on smaller tobacco companies who do not also sign on to the arrangement.²²⁵ The agreement and implementing statutes therefore create a cartel much like the one at issue in *Bates*: they seek to suspend price competition among a group of producers but leave it to those producers to select their own prices.²²⁶ Unlike, however, the *Bates* cartel, the tobacco arrangement also serves as a source of state revenues, and therefore raises the question whether a state may create an unregulated cartel or monopoly if it also skims from the higher profits thereby reaped. The argument in favor, which states have raised in defense of the tobacco cartel,²²⁷ is that any tax injures consumers by raising prices, and therefore the particular manner in which a state collects revenues is not a federal antitrust concern.²²⁸

Despite the superficial resemblance between the tobacco arrangement and a sales or income tax, there are good reasons that states should not normally be allowed to raise revenues by creating unregulated cartels or monopolies. One reason is that a cartel or monopoly license often enriches participating producers, and thus creates heightened tension with the Sherman Act by meeting *both* core criteria of antitrust invalidity. A mere sales or income tax, by contrast, injures producers and consumers alike. A second reason is that a blanket dispensation for schemes that raise public revenues would make it too easy for states to circumvent federal antitrust policy by levying minimal taxes on every monopoly or cartel they create, or indeed by simply noting that firms protected from competition pay more in income taxes. Courts could try to differentiate real from pro forma state revenue measures by requiring states to

223. See *Freedom Holdings, Inc. v. Spitzer*, 357 F.3d 205, 210 (2d Cir. 2004).

224. *Id.*

225. *Id.* at 213.

226. See *id.* at 213 (noting that the state statutes contemplated by the agreement would render the tobacco cartel “immune to price competition”). The tobacco arrangement is not a cartel in the strict sense that it involves horizontal price fixing; rather, it undermines price competition in a way that makes price-fixing unnecessary.

227. See *id.* at 229. States also have argued that the increase in prices caused by the tobacco cartel benefits the public because smoking is unhealthy. *Freedom Holdings, Inc. v. Spitzer*, 2004 WL 2035334, at *18 (S.D.N.Y. Sept. 14, 2004). Under my proposed preemption doctrine, the likelihood of such non-producer benefits would justify a law that merely created entry barriers. But when states instead seek to suspend price competition as they seemingly have done under the tobacco arrangement, they strike at the core of the Sherman Act, and so the possibility of such benefits is insufficient to justify the regime. States could achieve the same non-producer benefits by means that are far less offensive to federal antitrust policy, such as by imposing a tax that does not enrich producers or by regulating the prices charged by cartel members.

228. See Lopatka, *supra* note 62, at 65 (noting that excise taxes and state-run monopolies are interchangeable for public revenue purposes).

seize some minimum percentage of the monopoly profits, but direct measurement of monopoly returns is notoriously difficult, and any minimum percentage specified by courts would be inherently arbitrary. The only revenue-raising measure that seemingly avoids these objections is a monopoly license sold at public auction, the sales price of which will (if the auction is competitive) equal the difference between the license holder's expected profits and a normal return on investor capital. By seizing that difference, a state demonstrates that its primary goal in issuing the license is to raise public revenues rather than to confer net monopoly profits on a particular producer. There is no indication, however, that a competitive bidding process determined the amount of state revenues to be collected under the Master Settlement Agreement; indeed, that agreement covers all major tobacco producers, who therefore would have had no incentive to bid against each other (rather than collusively) on the "price" for the cartel license. For this reason, the connection between the laws implementing the tobacco cartel and state revenues would not save those laws from preemption under my proposed approach.

I provide a final example of a state regime preempted by the Act's section 1, this time hypothetical, to illustrate the relationship between preemption and violation under my proposal. In theory, horizontal price-fixing agreements might be enforceable under a state's law of contracts, perhaps because that state's judiciary has rejected the common law on restraints of trade. If a party to a price-fixing agreement in such a state were therefore to sue in state court for breach, under my preemption approach the defendant could argue that the Sherman Act preempts the state's contract law to the extent it would enforce the agreement. The reason is that, by lending its weight to the agreement, the state would be promoting a cartel but not regulating the prices charged. Of course, the fact that horizontal price-fixing agreements are federal crimes makes a lawsuit to enforce one fantastic. The hypothetical nonetheless illustrates that state law can be preempted under my approach if it rewards or encourages violations of the Act.²²⁹ But it does not follow that such state laws are the *only* type that conflict with the Act; after all, both the *Bates* regime and the tobacco agreement reveal that state lawmakers can easily create a cartel which evades the agreement requirement of section 1 but nonetheless undermines federal antitrust policy. And of course if a state were to allow horizontal price-fixing among producers but, as in *Motor Carriers*, also control the prices that the producers ultimately charge, the regime would be valid.

229. This observation redeems the Supreme Court's dictum in *Parker* that "a state does not give immunity to those who violate the Sherman Act by authorizing them to violate it, or by declaring that their action is lawful." *Parker v. Brown*, 317 U.S. 341, 351 (1943). But of course states do precisely that when they authorize horizontal price-fixing in regimes such as the one at issue in *Motor Carriers*. The Court's assertion can nonetheless be salvaged if restated as follows: when a state regime encourages horizontal price-fixing but does not regulate the prices charged, the regime is preempted and therefore cannot support exemptions for the Sherman Act violations it authorizes.

Thus, under my proposed approach an antitrust violation is neither necessary nor sufficient for a finding of preemption.

The ability of state lawmakers to undermine the purpose of the Act's section 2 without encouraging an antitrust violation is demonstrated by *Arsberry*, the case in which a state provided private firms with exclusive licenses to sell telephone services in prisons. Unlike *Endsley*, this case indisputably involved monopolies protected by state law, with prison walls serving as entry barriers of the most literal form. Moreover, the state did not regulate the prices charged; it instead allowed the phone companies to set the prices but then took for itself half the revenues collected. The arrangement thereby illustrates the point that a state will suspend price competition but not regulate the prices charged if the state's goal is to maximize marketplace wealth transfers from consumers to producers.²³⁰ As I have noted, Judge Posner ordered the case dismissed on grounds that a firm does not commit an antitrust violation merely by being a monopolist or charging monopoly prices. Though Judge Posner was right about the lack of an antitrust violation, his analysis failed to address the case's conspicuous Supremacy Clause question. The best that can be said for the court's ultimate ruling against the plaintiffs was that the high percentage of monopoly revenues seized by the state evinced that the monopoly licenses had a bona fide purpose to confer economic benefits on someone other than just the license holders. But an explicit ruling on that basis would have forced courts to draw arbitrary lines in future cases, when for example a state seized only forty percent of a monopolist's revenues, or thirty percent, and so on. The better approach in cases such as *Arsberry* is therefore to disallow a state from issuing a license that produces a monopoly unless the state sells the license at auction or regulates the price charged. States unable to accept such conditions would be limited to revenue-raising measures that do not also enrich producers.

States do not always issue monopoly licenses in order to raise public revenues, a fact demonstrated by *Electrical Inspectors, Inc. v. Village of East Hills*,²³¹ a case recently decided by the Second Circuit. A town had enacted an ordinance forbidding the occupation of private buildings whose wiring had not been inspected by a particular corporation the town had designated.²³² That corporation charged property owners an inspection fee which the town did not regulate,²³³ establishing conflict under my approach between the Act's section 2 and the corporation's monopoly in government-required inspection services. Moreover, the town did not sell the monopoly license through a public auction;

230. Strictly speaking, the state's cut was half of revenues, not profits. Given, however, that the marginal cost of long-distance phone service is minimal, the companies' incentive to maximize profits was aligned with the state's interest in maximal revenues.

231. 320 F.3d 110 (2d Cir. 2003).

232. *Id.* at 115.

233. *Id.* at 116.

in fact, the town did not share at all in the corporation's revenues. Finally, there was no indication that the corporation received its privileged position as a reward for innovation beneficial to consumers. The Second Circuit vacated the lower court's ruling on narrow grounds and did not reach the "violation" question.²³⁴ Under my approach the court could have ruled the town ordinance preempted and thus unenforceable;²³⁵ indeed, it is difficult to think of a state regime in greater conflict with federal antitrust policy than one that creates a monopoly but does not regulate the price the monopolist charges.

CONCLUSION

The Supreme Court's doctrine for analyzing conflict between state law and federal antitrust policy formally recognizes no difference between conduct that violates the Sherman Act and regulation that conflicts with it. But because the Court has deemed state regulations invalid notwithstanding the lack of any such violation, the Court's outward explanations for its rulings have been fictive or conclusory, and the relevant adjudicative criteria have remained unrealized. Lower courts have been left to choose between ignoring preemption issues altogether, thus spurning the Supremacy Clause, and engaging in open-ended review of state economic policies, thus donning a mantle deemed illegitimate since the repudiation of *Lochner*. The solution is to make the distinction between questions of preemption and violation explicit and to ground preemption analysis in both a plausible statement of congressional intent and a definition of the judicial role that eschews normative policymaking.

The substantive provisions of the Sherman Act describe a congressional purpose to prevent producers from enriching themselves by suspending competition and thereby raising prices paid by consumers. But an evident congressional intent to preserve state regulatory authority suggests that states should be accorded a level of deference not extended to market participants unless a state law suspends price competition to pursue profit-maximizing rather than "fair" or "reasonable" prices. Such considerations argue for limiting antitrust preemption to those state laws that raise prices to enable producers to achieve monopoly profits.

While the public or private status of regulatory decision-makers determines a state regime's validity under prevailing doctrine, the Court has failed to

234. *Id.* at 129.

235. As in most state-action immunity cases, the plaintiffs in *Electrical Inspectors* apparently failed to plead their violation and preemption claims separately. It is important to note in this regard that the defendant corporation's mere possession of a monopoly and potential charging of monopoly prices were not antitrust violations and therefore could not have subjected the corporation to damages claims, even if the town ordinance were preempted.

explain that distinction's relevance in the preemption context. I observe that control by state officials over market prices imposes public costs that the state could avoid if its goal were to maximize producer profits. Although this fit between regulatory process and purpose is necessarily imperfect, ongoing refinement of doctrinal rules is only possible if meaningful doctrinal goals have been defined. I begin that task here by situating conflict between federal antitrust policy and state economic regulation in its proper analytic framework of preemption under the Supremacy Clause.