

Judicial review of anticompetitive state action: two models in comparative perspective

Daniel A. Crane*

At present, there are two primary models of judicial review of state regulatory decisions that impair competition. A representation reinforcement model, associated with the *Midcal* approach in the USA, seeks to make state regulators politically accountable when they take decisions impairing competition. A substantive view model, associated with aspects of EU competition law and freedom of movement jurisprudence, has judges substantively review the merits of the regulatory decision. Both models have significant drawbacks. The representation reinforcement model often fails because of cost externalization on non-voters or asymmetries between the concentration of benefits on producers and the diffusion of costs on consumers. The substantive review model can create problems of counter-majoritarianism and judicial legitimacy. The weaknesses of the two dominant models suggest that countries implementing new mechanisms of judicial control over regulatory decisions should consider the creation of alternative models.

Keywords: state action, anticompetitive, Parker, *Midcal*, countermajoritarian, transplantation

JEL codes: K10, K21, K41, L41, L44 and L49

I. Introduction

States often regulate in ways that distort market competition. The question then arises whether such anticompetitive state regulatory schemes should be preempted by statutes or treaties that protect competition, or whether the regulatory schemes should instead prevail. Any legal system that both regulates and enacts laws promoting competition must create legal mechanisms to decide which body of law gives way given these inevitable conflicts.

* Professor of Law, University of Michigan. I am grateful to Eleanor Fox, Mel Marquis, and many participants at the Antitrust Enforcement Symposium held at Oxford University for useful comments on an earlier draft of this article. Email: danocrane@umich.edu.

© The Author 2013. Published by Oxford University Press. All rights reserved. For permissions, please e-mail: journals.permissions@oup.com

This Article examines two leading models for judicial review of state action that produces anticompetitive effects. The first is a representation reinforcement model under which courts do not consider the substantive justifications for the anticompetitive state action but only insist that the decision to take the action was made in a way that ensures political accountability. The second is a substantive review model under which the state must justify its anticompetitive act as reasonably related to some important state interest.

Aspects of these two models are presented in different standards used by legal systems to address state action that impairs free competition. The representation reinforcement model largely corresponds to the system currently utilized in the USA to determine whether state regulations are preempted by the federal antitrust laws. Aspects of a substantive review approach can be seen in European decisions concerning restrictions on the free movement of goods and services and the provisions of Article 106(2) of the Treaty on the Functioning of the European Union (TFEU) concerning compliance with competition principles by state-sponsored undertakings.¹ The purpose of this article is not to explore those doctrinal bodies systematically but rather to provide illustrations of representation reinforcement and substantive review strands in the US and EU law in order to give concrete shape to the theoretical models.

The problem addressed by these models is ubiquitous and will have to be faced by every jurisdiction contemplating judicial control over anticompetitive state action. Some of the jurisdictions that have recently adopted or updated their antitrust laws have addressed the state action head-on in their legislation. China's Anti-Monopoly Law expressly prohibits administrative agencies and other organs of the state to take unjustified actions that limit competition.² India's Competition Act allows the Central Government to exempt 'any class of enterprise' from the operation of the Act, but only if the exemption is 'in the interest of the security of the State or public interest'.³ Still, such general statutory provisions often do not answer the hard questions about forms and standards of scrutiny available to reviewing courts.

In the first section of this article, I sketch the contours of the two models. In the second section, I discuss some of the drawbacks to each of the models. In particular, the representation reinforcement model often fails to ensure political legitimacy because states externalize costs on non-voters, target politically vulnerable populations, or face agency capture problems when the costs of anticompetitive conduct are diffuse and the benefits concentrated on a small number of producers. The substantive review model is also subject to significant

¹ Article 106(2) provides that '[u]ndertakings entrusted with the operation of services of general economic interest or having the character of a revenue-producing monopoly shall be subject to the rules contained in the Treaties, in particular to the rules on competition, in so far as the application of such rules does not obstruct the performance, in law or in fact, of the particular tasks assigned to them'.

² Eleanor M Fox, *An 'Anti-Monopoly Law for China—Scaling the Wall of Government Restraints'* (2008) 75 *Antitrust L J* 173.

³ India Competition Act 2002, art 54, as amended.

drawbacks. It requires judges to consider displacing the political judgments of the executive or legislative branches based on often idiosyncratic determinations of what counts as a sufficiently compelling state interest. In the final section, I ponder whether these limitations to the process reinforcement and substantive review models are equally applicable if the models are transported into new antitrust jurisdictions.

II. The Two Models

Representation reinforcement

The American state action doctrine derives from *Parker v Brown*,⁴ in which the Supreme Court rejected both negative commerce clause and Sherman Act challenges to a California agricultural proration scheme that sharply limited the volume of raisins produced and marketed in the state. In *Parker*, the Court found ‘no suggestion of a purpose to restrain state action in the [Sherman] Act’s legislative history’.⁵ Later cases fleshed out the scope of *Parker* immunity for state action. In particular, in *Midcal*⁶ the Court announced a two-part test to determine whether *Parker* immunity applies. Under the first prong, the ‘challenged restraint must be one clearly articulated and affirmatively expressed as state policy’.⁷ Under the second prong, the state itself must ‘actively supervise’ the implementation of the competition-displacing policy.⁸

Although the US Supreme Court has justified the *Parker* doctrine as ‘grounded in principles of federalism’,⁹ the principle has broader application than managing the competing policies of multiple sovereigns in a federal system. For instance, there is no federalism problem with federal legislation displacing the policy choices of federal instrumentalities, but the courts have nonetheless applied *Parker*-type reasoning to anticompetitive schemes by federal instrumentalities, such as the District of Columbia Armory Board, the National Science Foundation, and the Government of Guam.¹⁰

More fundamentally, the *Parker* doctrine is not really about respecting the state’s policy choices in a broad sense, but about not displacing a state’s regulatory schemes. A state that prefers a laissez faire approach to competition cannot

⁴ 317 US 341 (1943).

⁵ *ibid* 351.

⁶ *California Retail Liquor Dealers Ass’n v Midcal Aluminum, Inc*, 445 US 97 (1980).

⁷ *ibid* 105 (citations omitted).

⁸ *ibid*.

⁹ *Fed Trade Comm’n v Ticor Title Ins Co.*, 504 US 621, 633 (1992). See also Einer Elhauge, ‘The Scope of Antitrust Process’ (1991) 104 Harv L Rev 667 (exploring federalism dimensions of *Parker* doctrine).

¹⁰ *Hecht v Pro-Football, Inc*, 444 F.2d 931 (DC Cir 1971); *Thomas v Network Solutions, Inc*, 176 F.3d 500 (DC 1999); *Sakamoto v Duty Free Shoppers, Ltd*, 764 F.2d 1285 (9th Cir. 1985); see also *Sea-Land Service, Inc v Alaska R R*, 659 F.2 243 (DC 1981) (federal railroad immune from Sherman Act suit); *Jackson v West Indian Co, Ltd*, 944 F Supp 423 (D V I 1996) (exploring potential differences between federal instrumentality and state instrumentality immunities).

simply announce that it is becoming an antitrust-free zone in which the federal antitrust laws do not apply. Nor can it simply delegate self-regulatory authority to private actors. In order to qualify for *Parker* immunity, the states have to come up with a regulatory scheme and actively supervise its implementation.

Parker immunity is conceptually predicated not so much on federalism as on a political accountability model of regulatory design.¹¹ The basic idea is that, if a government wants to displace the usual rules of competition with an alternative scheme, it must do so obviously and conspicuously (clear articulation and affirmative expression) and it must take full responsibility for the way in which the alternative policy is implemented (active supervision). In this way, the government itself will become politically responsible for the displacement of competition. If things go poorly, the electorate can trace the decision back to the responsible government and punish it appropriately.

This political accountability approach to anticompetitive state action reflects one of the most popular constitutional theories of the last half century: John Hart Ely's theory of representation reinforcement. In *Democracy and Distrust*,¹² Ely advanced the argument that the courts should not override the will of the majority in service of values higher than majority rule. Rather, the courts should strive to make democracy work better—to break down impediments to meaningful majority and minority participation in the political process and hence promote the legitimacy of the political system.

The representation reinforcement model provides insights into the implicit theory of *Parker* immunity. *Parker* was decided in an era in which the courts were retreating from their project in the early 20th century of invalidating socio-economic legislation (both state and federal) under substantive due process principles, which required courts to decide substantively what economic policies were legitimate and which were not.¹³ When the Supreme Court began to retreat from economic substantive due process in the late 1930s, it asserted that courts could not legitimately decide questions of socio-economic policy and that those questions should be left to legislators.¹⁴ Having made this turn away from judicial creation of economic policy under the guise of the due process clause, the court was hardly prepared to take on a similar role under the antitrust laws.

¹¹ See eg William H Page and John E Lopatka, 'State Regulation in the Shadow of Antitrust: FTC v. Ticor Title Ins. Co' (1993) 3 Sup Ct Econ Rev 189, 229.

¹² John Hart Ely, *Democracy and Distrust: A Theory of Judicial Review* (Harvard University Press 1980).

¹³ Paul R Verkuil, 'State Action, Due Process, and Antitrust: Reflections on Parker v. Brown' (1975) 75 Colum L Rev 328, 330–41.

¹⁴ See eg *US v Carolene Prods Co*, 304 US 144, 152 (1938) ('[T]he existence of facts supporting the legislative judgment is to be presumed, for regulatory legislation affecting ordinary commercial transactions is not to be pronounced unconstitutional unless in the light of the facts made known or generally assumed it is of such a character as to preclude the assumption that it rests upon some rational basis within the knowledge and experience of the legislators.');

Ferguson v Skrupa, 372 US 726, 730 (1963) (examining historical rejection of economic substantive due process and explaining that 'courts do not substitute their social and economic beliefs for the judgment of legislative bodies, who are elected to pass laws').

But this did not mean that the courts would abdicate on state economic policies altogether. Rather than substantively second-guessing state economic policies, the courts would inquire into the political legitimacy of the processes that produced the anticompetitive scheme. Hence, the Court has not hesitated to strike down anticompetitive state policies that fail the *Midcal* test—ones that where the state does not take clear political responsibility for the scheme.¹⁵ In this way, the *Parker* doctrine ostensibly strengthens the political processes through which economic regulation flows.

Substantive review

State regulations that restrict competition are more likely to undergo substantive review by courts in the EU, although not necessarily under competition law principles. Under current EU law, the courts and European Commission are at least sometimes directed to answer the questions that *Parker* and its progeny have directed courts to eschew: whether the state action is justified by substantive policy considerations. Some of these cases arise under Article 56 TFEU (ex-Article 49 EC), which prohibits unjustified restrictions on the provision of cross-border services.¹⁶ Others, like the *Slovakian hybrid mail case* discussed below, arise under Article 106(2) and Article 102, which directly covers competition law.

An example of a case decided under Article 56 TFEU is the *Italian legal fee regulation cases*,¹⁷ where the European Court of Justice (ECJ) explained that restrictions on competition that produce anticompetitive effects may sometimes be justified given a sufficiently important state interest and a reasonable relationship between the restriction and the state's important goal:

In that respect, it must be pointed out that, first, the protection of consumers, in particular recipients of the legal services provided by persons concerned in the administration of justice and, secondly, the safeguarding of the proper administration of justice, are objectives to be included among those which may be regarded as overriding requirements relating to the public interest capable of justifying a restriction on freedom to provide services. . . . on condition, first, that the national measure at issue in the main proceedings is suitable for securing the attainment of the objective pursued and, secondly, it does not go beyond what is necessary in order to attain that objective.¹⁸

¹⁵ Daniel A Crane, *The Institutional Structure of Antitrust Enforcement* (Oxford University Press 2011).

¹⁶ See eg *Cipolla v Fazari*, C-94/04 and C-202/04 (ECJ) (rejecting Article 10 and 81 challenges to Italian statutory fee scale but upholding same challenge under free movement principles); *Societe Zeturf Ltd v Premier Ministre*, Case C-212/08 (ECJ) (holding under Article 49 that '[n]ational legislation [creating gambling restrictions] is appropriate for ensuring attainment of the objective pursued – combating criminal and fraudulent activities and protecting society – only if it genuinely reflects a concern to attain it in a consistent and systematic manner').

¹⁷ *Cipolla v Fazari* and *Macrino v Meloni*, Joined Cases C-94/04 and C-202/04, [2006]. ECR I-11421, ECJ.

¹⁸ *ibid* para 64.

The *Slovakian hybrid mail case*¹⁹ involved competition law principles and hence a different set of doctrinal and analytical questions, but, at its core, a comparable inquiry into the substantive justifications for the state's restrictions of competition. The European Commission held that the Slovak Republic's extension of its postal monopoly to hybrid mail (mail electronically transmitted to a service provider and printed, put into an envelope, and delivered by the provider) conflicted with Article 106(2)'s requirement that Member States comply with EU competition rules—in this case Article 102's prohibition on abuse of a dominant position. The Commission first found that Slovenská Pošta held a dominant position within the meaning of Article 102.²⁰ It then observed that the Commission's 1998 Postal Notice stressed that 'the use, without objective justification, or a dominant position in one market to obtain market power on related or neighboring markets which are distinct from the former or at the risk of eliminating competition on those markets' would be contrary to Articles 106 in conjunction with Article 102.²¹ The Commission further noted that this would only be the case 'in the absence of specific justification, if the functioning of services in the general economic interest was not previously endangered'.²² Having found that Slovenská Pošta had used its dominant position in one market to obtain a dominant position in another, it then placed the burden of justifying the state-sponsored restraint on competition on Slovenská Pošta. Slovakia argued, among other things, that Slovenská Pošta's 'profits would be reduced... to such an extent that they would not cover the costs of providing the postal universal service and that competition would impact negatively its revenues due to the diversion of large volumes of bulk mail items to hybrid mail'.²³ The Commission considered this assertion at length, and found that Slovakia had failed to substantiate its claim that allowing private hybrid mail delivery would undermine the state's ability to provide universal postal service. In other words, the Commission engaged in a substantive review of the anticompetitive regulatory scheme, ascertaining whether it was necessary to advance the state's legitimate interests.

This sort of substantive review of anticompetitive state action resonates with US constitutional doctrines that require state action that burdens some freedom or interest (such as free speech or gender equality) to meet a two-part test: (i) that the state action serves some compelling or at least important state interest; and (ii) that the state action is narrowly tailored to meet the state's interest.²⁴

¹⁹ *Slovakian Postal Legislation Relating to Hybrid Mail Services*, Commission Decision of 7 October 2008, Case COMP/39.562, OJ C322 (17 December 2008).

²⁰ *ibid* para 113.

²¹ *ibid* para 114.

²² *ibid*

²³ *ibid* para 161.

²⁴ The EU's ends-means test is often called a 'proportionality' test, consistent with the general principle of proportionality in EU jurisprudence. Damien Chalmers and others, *European Union Law* (Cambridge University Press 2010), 368–69.

Such tests can be phrased in varying degrees of strictness (ie ‘compelling’ or merely ‘important’) reflecting the degree of prima facie hostility the judiciary will manifest to the state action. In the USA today, such tests are generally reserved for non-economic questions involving personal freedom, equality, or social standing.

III. The dilemmas

Failures of political representation

Cost externalization on non-voters

The representation reinforcement model is premised on the assumption that when governments are forced to take visible responsibility for their regulatory decisions, the democratic process will hold them accountable when the costs of displacing competition with regulation exceed the benefits.²⁵ But this political accountability story does not work as to anticompetitive regulations whose benefits are captured mostly by local producers and costs externalized to consumers who cannot vote in the jurisdiction that imposed the anticompetitive regulation. Consider the facts of *Olsen v Smith*,²⁶ the first US Supreme Court decision to consider the relationship between the Sherman Act and anticompetitive state regulations. The plaintiffs were pilots whom the State of Texas had granted an exclusive right ‘to pilot sail vessels or registered steamers, bound to or from foreign ports, in or out of the port of Galveston’.²⁷ They sued a pilot, not lucky enough to be part of the monopoly, for unlawfully diverting business. One might sympathize with the state’s regulatory ambition—after all, who wants want unskilled pilots driving boats through Galveston harbour? But it turns out that the state’s ‘regulatory’ scheme had nothing to do with protecting the health and safety of innocent longshoremen. The statute exempted vessels ‘owned in the state of Texas, and licensed in the district of Texas, when arriving from or departing to any port of the state of Texas’.²⁸ The statute was simply designed to exact rents from foreign vessels and/or foreign commerce while immunizing local vessels in local commerce. The defendant raised the Sherman Act as a defence, to no avail. The Court held that the power to regulate included the power to create monopoly.²⁹

²⁵ Robert P Inman and Daniel L Rubinfeld, ‘Making Sense of the State Action Doctrine: Balancing Political Participation and Economic Efficiency in Regulatory Federalism’ (1997) 75 Tex L Rev 1203, 1207. Inman and Rubinfeld would ask: ‘1) Does a state regulation generate significant monopoly spillovers onto nonresidents?; and 2) Was the state regulation decided without political participation of the affected nonresidents as evidenced by the lack of interstate regulatory agreement? If the answer to both questions is yes, then the state regulation fails the spillover test for economic efficiency, and a Sherman Act review of the regulation is appropriate.’ *ibid.*

²⁶ 195 US 332 (1904).

²⁷ *ibid* 338.

²⁸ *ibid* 340–41.

²⁹ *ibid* 344–45.

An equally striking example of externalization of monopoly costs can be seen in *Parker*, the case that created the modern doctrine of antitrust immunity for state regulations.³⁰ Significantly, at the time of *Parker*, half of the world's raisins and 95 per cent of raisins sold in the USA came from California.³¹ Further, more than 90 per cent of the raisins grown in California were shipped outside of the state.³² Hence, California raisin producers had significant market power and were able to export most of the costs of their cartel to consumers who had no say in California politics. Nonetheless, the Supreme Court held that the California scheme was categorically immunized from antitrust challenge.

For another example of possible externalization of costs on non-voters, consider the facts of *Town of Hallie v City of Eau Claire*.³³ The towns of Hallie, Seymour, Union, and Washington were unincorporated areas adjacent to the city of Eau Claire, Wisconsin. The citizens of those towns could not vote in Eau Claire, although it was evidently Eau Claire's intentions to annex those territories. Eau Claire received federal funds to build a sewage treatment plant in the Eau Claire service area, which included the four towns.³⁴ The city then refused to supply sewage treatment services to the towns. It agreed, however, to provide treatment services to select homeowners within the towns if a majority of the voters in the area voted by referendum to have their homes annexed by the city and to use Eau Claire's sewage collection and transportation services.³⁵ According to the towns, the effect of this scheme was to prevent the towns from emerging as effective competitors to Eau Claire in sewage collection and transportation. It also may have allowed Eau Claire to increase costs to non-residents, even while using the higher prices as leverage to bring them (and presumably their property taxes) into the city. Nonetheless, because the anti-competitive policy was approved by the state and sufficiently supervised by its agents, it was immune from federal antitrust scrutiny.

Perversely, *Parker*, *Midcal*, and their progeny created an even worse problem than the ordinary export cartel.³⁶ Recall that for a state regulatory scheme to qualify for *Parker* immunity, it must be affirmatively expressed as state policy and actively supervised by agents of the state. This means that it is usually not enough for a state to passively allow anti-competitive conduct to take place. It must require it—or at least come very close to requiring it³⁷—and then actively

³⁰ 317 US 341 (1943).

³¹ *ibid* 344.

³² *ibid*

³³ 471 US 34 (1985).

³⁴ *ibid* 37.

³⁵ *ibid*

³⁶ See Frank H Easterbrook, 'Antitrust and the Economics of Federalism' in Richard A Epstein and Michael S Greve, *Competition Laws in Conflict: Antitrust Jurisdiction in the Global Economy* (AEI Press 2004) 189–213.

³⁷ A state regulatory policy can qualify for *Parker* immunity even if the state does not compel market actors to adhere to the regulatory scheme. *Southern Motor Carriers Rate Conf., Inc v US*, 471 US 48, 61 (1985). Nevertheless, state compulsion is often considered the 'best evidence' that the policy of displacing competition is clearly articulated and affirmatively expressed as state policy. *ibid*.

monitor it. The upshot is that states often play the role of cartel ringmaster, thus solving the cartel's perennial problem of preventing defection. Thus, unlike mere private market cartels, which may eventually collapse under their own weight, state-run cartels are backed by the coercive power of the state and hence are stable and perniciously effective.

Antitrust-immunized state-run cartels are highly effective methods of externalizing costs on people who have no say in the matter. In such circumstances, the representation reinforcement model of state regulation misses the target entirely.

Democratic failure within a regulating jurisdiction

The representation reinforcement model assumes that if governmental policy causing excessive economic harm is visibly identified with the government, political pressures will force the government to reconsider its policy. But even as to effects that are internalized within the regulating jurisdiction, that assumption often does not hold. A body of public-choice theory suggests that anticompetitive schemes may be the product of regulatory capture by powerful industries and the diffusion of costs over a wide body of consumers who do not have a sufficient individual interest to mobilize politically and resist.³⁸ Further, to the extent that the costs of anticompetitive regulations are sometimes concentrated rather than diffuse, they are often concentrated on groups of relatively powerless producers who do not have the connections or political capital to secure relief through the political process.

Consider a case that was recently litigated in Louisiana. Until recently, the Benedictine monks of St Joseph's Abbey in Louisiana led a relatively quiet existence since establishing their abbey in 1889.³⁹ In 2005, Hurricane Katrina destroyed part of the abbey's pine timberlands, which the abbey harvests to support itself. In need of an alternative source of income, the monks decided to get into the casket business, hand-making two models of 'blessed' pine caskets in their workshop. Before they had sold a single casket, the monks received a cease and desist order from the Louisiana State Board of Embalmers and Funeral Directors. The monks were informed that they were not allowed to sell caskets unless they 'become a licensed funeral establishment, which would require a layout parlor for 30 people, a display area for the coffins, the employment of a licensed funeral director and an embalming room'.⁴⁰ These conditions meant, in effect, that the monks were prohibited from getting into the casket business.

³⁸ See eg Merrick B Garland, 'Antitrust and State Action: Economic Efficiency and the Political Process' (1987) 96 Yale LJ 486; John Shepherd Wiley, Jr, 'A Capture Theory of Antitrust Federalism' (1986) 99 Harv L Rev 713.

³⁹ The facts reported here are taken from Robert Barnes, 'Louisiana Monks Go to Court to Sell Their Caskets' <http://www.washingtonpost.com/politics/louisiana-monks-go-to-court-to-sell-their-caskets/2012/05/29/gJQA7VMK0U_story.html> accessed 6 June 2013.

⁴⁰ *ibid.*

The monks brought a constitutional challenge and won a surprising victory in the United States Court of Appeals for the Fifth Circuit, which held that ‘mere economic protection of a particular industry’ is not ‘a legitimate governmental purpose’.⁴¹ Similar constitutional challenges have had mixed results in other federal courts of appeal.⁴² Under the currently applicable ‘rational basis’ model for reviewing the constitutionality of state socio-economic legislation, constitutional challenges to such restrictions are difficult.

One legal approach that most probably would not apply on these facts is antitrust law, even though the restriction has obvious anticompetitive effects. The undertakers could easily pass the *Midcal* test, since the state legislature has expressly granted the embalming board regulatory authority and they remain subject to the supervisory authority of the Department of Health and Hospitals.

Now consider how well the political accountability account of *Midcal* works in these circumstances. The political dynamics are set up for democratic failure. A relatively small group of producers with a large stake in the continuation of the anticompetitive scheme will exercise its full political clout to sustain the scheme. The harms of the scheme fall largely on two groups—consumers and ‘outsiders’ to the regulatory scheme like the monks of St Joseph’s Abbey. Consumers can hardly be expected to mobilize politically to oppose restrictions on casket making. The injury to any individual casket purchaser is relatively small—somewhat higher prices and decreased variety. More importantly, most people will (hopefully) buy relatively few caskets in their lifetime and, when they do buy a casket, will not be in an emotional state to focus heavily on the price. Also, some buyers will have funeral insurance or other sources of funding to cover funeral expenses (such as family contributions), which may contribute to them paying relatively little attention to price.

In contrast to consumers, the monks (and other potential new entrants) do face a concentrated injury that could dispose them (and, in this case has disposed them) to fight legally and politically. But the monks are outsiders to the state embalming board and the state legislature, and do not have the longstanding clout of the established funeral homes. The state representative for the monks’ district introduced legislation that would have allowed the monks to proceed with their casket business, but the funeral directors had it killed in committee. If a group as sympathetic as casket-making monks cannot obtain the political traction for legislative reform, it is highly doubtful that ordinary entrepreneurs could do so. As the US Court of Appeals for the 10th Circuit noted in upholding a similar casket law against constitutional challenge, ‘while baseball may be the national pastime of the citizenry, dishing out special economic benefits to certain

⁴¹ *St Joseph Abbey v Castille*, ___ F.3d ___, 2013 WL 1149579, at *5 (5th Cir 2013).

⁴² See *Powers v Harris*, 379 F.3d 1208 (10th Cir 2004) (upholding Oklahoma law restricting sale of caskets to licensed funeral directors); *Caigniles v Giles*, 312 F.3d 220 (6th Cir 2002) (invalidating similar Tennessee law).

in-state industries remains the favored pastime of state and local governments'.⁴³

To be sure, it is possible that the restriction on casket sales is justified by legitimate regulatory objectives, such as preventing the exploitation of grieving families or ghoulish accidents with the bodies of the deceased. But under contemporary US antitrust principles, any such justifications will not be evaluated by the judiciary. Nor will the electorate's ability to trace the responsibility for the decision to the state likely make much of a difference.

This is not to say that US antitrust law is completely ineffective at thwarting anticompetitive state action. In a number of cases, courts have invalidated anticompetitive state actions that were little more than delegations of power to private actors to engage in anticompetitive behaviour. The presence of public officials in the administration of regulatory schemes that displace competition may *sometimes* provide a meaningful check on the grossest abuses. But, of course, public choice theory has taught us that public officials should not be presumed to be acting in the public interest and may be subject to all sorts of capture or corruption. The US Supreme Court has resisted opening a capture or corruption loophole to state action immunity, out of fear that the loophole would swallow the rule.⁴⁴ Although we might hope that legal rules might counter capture and corruption by requiring public officials to take responsibility for anticompetitive schemes, that is unfortunately not usually the case for the reasons explored above.

Countermajoritarian difficulties

The previous section outlined some serious difficulties with the representation reinforcement model of judicial controls on anticompetitive state action. Alas, the substantive review model has its own serious challenges as well, which generally fall under the heading of what Yale Law professor Alexander Bickel called 'countermajoritarian difficulties'.⁴⁵ When a court invalidates subordinate legislation on the theory that it violates some higher law—such as a constitution, a treaty, or a preemptive statute in a federal system—it is trumping the democratically determined public will based on the opinions of unelected judges. Not surprisingly, decisions of the ECJ invalidating Member State regulations have sometimes encountered fierce backlashes. Similarly, the Slovak government angrily denounced the *Slovak hybrid mail* decision of the European Commission, and flatly refused to implement it.

The challenges of political legitimacy facing judges employing a substantive review approach fall analytically into two buckets, consistent with the two-part test generally applicable to state actions burdening protected individual rights. The first is to decide what state interests are sufficiently important to justify

⁴³ *Powers*, 379 F.3d at 1221.

⁴⁴ *City of Columbia v Omni Outdoor Advertising, Inc*, 499 US 365 (1991).

⁴⁵ Alexander M Bickel, *The Least Dangerous Branch* (2d edn, Yale University Press 1986) 16–23.

displacement of baseline competition principles. The second is to decide when the state regulatory scheme is sufficiently tailored to meet the state's important objectives.

Deciding what state interests are legitimate and important

The first prong in a substantive review test usually requires an inquiry into the legitimacy and magnitude of the state interest at issue. In the *Italian legal fee regulation* case, the ECJ acknowledged that safeguarding consumers against sharp practices by lawyers and preserving the integrity of the justice system are 'overriding requirements relating to the public interest'.⁴⁶ This formulation of the public interest component of substantive review implicitly contains two sub-components—legitimacy and magnitude. Firstly, the state interest must promote public, as opposed to private, welfare. Secondly, the state interest must be an important one in relation to society's interest in free competition. Both of these sub-components have their difficulties.

Firstly, the distinction between the public interest and the private interest is slippery at best.⁴⁷ Read narrowly, the public interest could be understood as just the interest of the state in the administration of governmental programmes (for example, integrity in public works programmes). But that understanding is certainly too narrow to comprehend the usage of the public interest requirement in EU law. Recall that in *Italian legal free regulation*, the relevant public interests included the administration of the justice system—which would meet the 'public' requirement in the narrow sense just articulated—but also the interests of clients in not being fleeced by lawyers, which could happen inside or outside of the public adjudication system. States frequently displace competition with regulation in order to protect the interests of 'private' constituencies such as consumers or producers.

If the public interest is not simply the interests of the government in administering its own programmes, then what is it? Given the usual assumption that competition laws are primarily oriented toward the promotion of consumer welfare, one might posit that the 'public interest' in the state action context simply means the interests of consumers as opposed to the interests of producers. But that approach may not be terribly appealing normatively because it would require disregarding the interests of producers, no matter how large in comparison to the interests of consumers. For example, it would prevent a state from deciding that a particular group of producers would benefit considerably from a regulatory scheme that made competition somewhat less intense and only caused a slight loss of consumer welfare. Equating the 'public interest' with consumer welfare would prohibit states from following a total social welfare maximization

⁴⁶ *Cipolla v Fazari and Macrino v Meloni*, Joined Cases C-94/04 and C-202/04, [2006]. ECR I-11421, ECJ.

⁴⁷ See, eg Alexander Meiklejohn, *Political Freedom: The Constitutional Powers of the People* (Greenwood Pub Group 1960) 80–81.

approach to regulatory decision-making and require them to focus narrowly on consumer welfare in cases where the regulation might impair the competitiveness of the market.

Alternatively, one could read the ‘public interest’ requirement as a rule that state actors are not allowed to bestow privileges on narrow special interest groups at the expense of the general population. But such a rule would be difficult to implement because there is no clear dividing line between ‘special interest groups’ and other constituencies deserving of state favour. Special interest group is little more than an epithet that one applies to political adversaries. Consider, for example, the *Italian Matches* case⁴⁸ in which Italian law required Italian match producers to join a consortium and to set sellers’ quotas—a case closely reminiscent of *Parker v Brown*.⁴⁹ Are match makers (the kinds that make sticks you can set on fire) a special interest group? If so, then isn’t every neighbourhood association that lobbies against a polluting factory, every union that seeks a more favourable labour law, and every group of inventors that seeks to strengthen the patent laws a special interest group as well?⁵⁰ As James Madison famously explained in *The Federalist No. 10*, self-interested factions are an inherent feature of democracy and governmental structures should seek to prevent any one faction from growing too powerful rather than seeking to eliminate factional intrigue.

Despite these difficulties, the public interest or legitimacy criterion has at least the potential to be intelligible. In contrast, the magnitude or ‘importance’ criterion does not—or, at least it is not as a *judicial* criterion. The problem is that judges have no comparative advantage over legislators or regulators to decide what interests are important. Furthermore, making the lawfulness of a regulation turn on the judges’ views on the comparative importance of different state interests seriously threatens the legitimacy of the judicial process.

Of course, judges make value judgments all of the time, but such judgments become highly sensitive when the judge is substituting her valuations for those of state actors in the legislative or executive—and hence more democratically accountable—branches. And although modern constitutional doctrine requires judges to determine the importance of asserted state interests in a variety of contexts such as racial or gender classifications and abridgements of free speech, determining the importance of the state’s interests in economic regulation is a very different matter. In the personal rights context, courts are not so much deciding what interests are important in the abstract as they are deciding

⁴⁸ *Conorzio Industrie Fiammiferi*, Case C-198/01, [2003] ECR I-8055, ECJ.

⁴⁹ See Eleanor M Fox, ‘State Action in Comparative Context: What if Parker v. Brown Were Italian?’ Fordham Corp L Inst, *International Antitrust Law & Policy* 463, 473, (Barry E Hawk ed., 2004).

⁵⁰ The historical evidence suggests that the bakeshop act invalidated by the US Supreme Court in *Lochner v New York*, 198 US 45 (1905), which is considered the peak of the Court’s now-rejected substantive due process jurisprudence, was the product of special interest agitation. See David E Bernstein, *Rehabilitating Lochner: Defending Individual Rights Against Progressive Reform* (University of Chicago Press 2011) 3.

whether the state's asserted interests are inconsistent with a moral principle embodied in a constitutional limitation. For example, when gender classifications are at issue, the courts examine the state's proffered justifications to determine whether they are inconsistent with the constitutional principle that state classifications should not be predicated on gender stereotypes or the subordination of women.⁵¹ Proffered state interests are usually not rejected because they are insufficiently weighty but because they are pretextual or categorically illegitimate.

There is no comparable categorical illegitimacy move available in competition law. Competition law is not premised on moral considerations about the dignity or worth of individuals and usually does not contain categorical prohibitions on the kinds of assumptions states may make or values they may seek to promote. To the extent that competition law does contain categorical prohibitions, they are decisional rules for streamlining litigation, not constraints on the range of options that *states* can consider. For example, the rule of *per se* illegality for price fixing and other naked horizontal restraints prohibits parties to argue in defence of a restraint that competition was 'ruinous' and therefore needed to be curtailed. But this rule does not rest on a legislative or judicial judgment that competition could never be ruinous and in need of curtailment. Rather, it is a probabilistic rule designed to minimize litigation costs and errors. Given that competition is usually beneficial to society and that parties who want to suppress competition will invariably argue that competition was deleterious, it is better to make a categorical judgment for purposes of antitrust litigation that competition is virtuous. Nothing in this reasoning, however, would prohibit a state from limiting competition in order to promote other social or economic values.

Asking courts to determine the strength of the state's interest in curtailing competition would be a judicially unmanageable task, requiring courts to engage in a sort of open-ended cost benefit analysis that would sometimes result in the judges substituting their view of what interests are important for those in the executive or legislative branches.

The tightness of means/ends fits

The second step in a substantive review model is to determine whether the restriction on competition is a reasonable means to pursue the state's regulatory goals—the fit between means and ends. The central challenge with any means/ends test is identifying the required tightness of the fit. The required relationship can be strict (ie the state restriction must be absolutely necessary to end), lax (ie the state restriction must be rationally related to the end) or anything in between. In the USA, the courts and agencies have generally not required too

⁵¹ See eg *US v Virginia*, 518 US 515, 533 (1996) (explaining that state interests in gender classification context 'must be genuine, not hypothesized or invented *post hoc* in response to litigation. And it must not rely on overbroad generalizations about the different talents, capacities, or preferences of males and females').

tight a means/ends fit between a restriction and its ends in the antitrust context. For example, the US Justice Department and Federal Trade Commission have stressed that a restriction may be ‘reasonably necessary without being essential’, that the agencies ‘consider only alternatives that are practical in the business situation faced by the participants’, and that the agencies ‘do not search for a theoretically less restrictive alternative that is not realistic given business realities’.⁵² In contrast, the European Commission has spoken about an ‘indispensability’ requirement for restrictions on competition in the Article 101 context,⁵³ suggesting a stricter level of scrutiny for certain restraints on competition.

In the state action context, the ECJ has expressed the means/ends criterion as requiring that the restraint on competition ‘is suitable for securing the attainment of the objective pursued and . . . does not go beyond what is necessary in order to attain that objective’.⁵⁴ This formulation suggests two components to the means/ends evaluation stage. Firstly, there is a question of alternatives—was there a different means of achieving the state’s regulatory goals without harming cross-border competition. Secondly, there is a question of breadth—even if the means chosen was reasonable, did it contain competition-harming features beyond the necessary scope of the chosen means.

Both of these components could prove tricky for judges to address. On the alternatives question, it is almost always the case that the state has alternative means of achieving its ends that do not involve an equally obvious impairment of competition. In the *Slovak Mail* case, for example, Slovakia could have allowed hybrid mail delivery and made up for the lost revenue streams through other devices, such as raising postage rates or general taxation. But although those other devices might not impair competition to the same degree, they might be not be politically feasible or might impair other socio-economic objectives of the mail system such as progressive wealth-transfers or subsidization of rural areas. Judges are in a very poor position to make decisions about these kinds of trade-offs given their systemic effects.

Similarly, the scope question will often be dicey in the state action context. Many statutory or regulatory schemes are explicable only as compromises between different interest groups. Hence, statutes and regulations are often populated with quirks—carve-outs, exemptions, special grants—that seem extraneous to the central workings of the statutory or regulatory scheme. But even if they look like chaff during post-hoc judicial inspection, they were often essential points of compromise that secured the political capital necessary for passage of the bill or regulation. Judicial invalidation of restrictions on competition as overbroad to the function of a statutory or regulatory scheme may excise *politically* indispensable features.

⁵² FTC & DoJ *Antitrust Guidelines for Collaborations Among Competitors* s 3.36(b)(April 2000).

⁵³ *Guidelines on the Applicability of Article 101 of the TFEU to Horizontal Cooperation Agreements*, <<http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2011:011:0001:0072:EN:PDF>> accessed 6 June 2013.

⁵⁴ *Cipolla v Fazzari and Macrino v Meloni*, Joined Cases C-94/04 and C-202/04, [2006]. ECR I-11421, ECJ.

Again, this observation is not unique to judicial review of anticompetitive state actions. The same could be said of judicial invalidation of features of business agreements between private parties—the relevant restrictions were necessary concessions if the deal was to close. The difference in the state action context is that when judges try to reengineer statutes or regulations to make them intrude less on competition, they may mangle deals crucial to economic progress cut by the political branches.

IV. Issues of transplantation

Process reinforcement

As discussed above, the US process reinforcement model does not provide an effective check on anticompetitive regulatory schemes in most cases because of cost externalization and diffusion. And that is an observation as to a political regime that ranks high on the Economist Intelligence Unit's democracy index and particularly on measures of citizen political involvement.⁵⁵ Given the model's failure to achieve meaningful improvements in the quality of regulation through enhanced citizen awareness and participation in a highly democratic and citizen-activist country, the model is very unlikely to be successful in regimes with far weaker democratic traditions or patterns of citizen mobilization and political involvement.

This is not to say that it is impossible to design a process-oriented model of state action review that improves regulatory outcomes. The US model is largely designed to deal with federal judicial management of state legislation that impairs competition and hence represents a potential clash of wills between courts of one sovereign and legislatures of another. In other contexts, federal courts employ controls on regulatory processes that stress transparency, accountability, and reasoned decision-making by administrative agencies. For example, courts may require that agencies provide notice and opportunity for public comment on new regulations, that agencies base their decision on facts contained in a public record, that agencies undertake cost-benefit analysis, and that the justifications for regulations asserted by the agencies be those that they relied on at the time of regulating rather than ones invented during the course of judicial review.⁵⁶ For example, US courts often engage in what is called 'hard look' review of administrative decisions to make sure that the agency has complied with a litany of

⁵⁵ The United States ranks 19th out of 167 countries surveyed overall in the EIU's 2011 survey. Economist Intelligence Unit Democracy Index 2011, <http://www.eiu.com/Handlers/WhitepaperHandler.ashx?fi=Democracy_Index_Final_Dec_2011.pdf&mode=wp&campaignid=DemocracyIndex2011> accessed 6 June 2013. The USA score for political participation 7.22, which makes it 12th on the list.

⁵⁶ See generally Lisa Schultz Bressman, Edward L. Rubin and Kevin M. Stack, *The Regulatory State* (Aspen Publishers 2010).

procedural requirements—some statutory and some invented by courts.⁵⁷ These sorts of administrative law controls are thought to improve the quality of regulation by requiring regulators to deliberate carefully and with full information, even if they do not entail extensive citizen participation in fact.

Such judicial review models might provide advantageous to competition regimes where the primary dialogue over state action decisions will be between courts and sectoral regulators. This is still process review—it does not entail full substantive engagement by courts—and hence avoids some of the problems with substantive due process or other forms of intensive substantive review. For that reason, it is also a fairly modest control on anticompetitive state action. Organized special interests intent on achieving cost-externalizing regulations may not be deterred by these sorts of transparency, reasoning-giving, and consultation obligations. But it can improve on the current US process reinforcement mode by dropping the assumption that the check will come through citizen engagement in the political process and instead incentivize regulators to think more fully and carefully before displacing competition.

Substantive review

As discussed above, the central challenge in a substantive review model is its antimajoritarian tendencies and hence its potential lack of political legitimacy. In the European context, the concern is that the politically distant European Commission and the politically unaccountable General Court or Court of Justice will substitute its own judgments about what is proper, important, rational, or necessary for those of the more politically accountable organs of the Member States. The same would be true of a substantive review model in the US, where unelected federal judges overruled legislative determinations by popularly elected politicians.

But this friction between the popular political class and the unelected judicial or politically distant technocratic classes need not be a universal objection to substantive review models. Substantive review may encounter fewer problems of legitimacy and political friction in other contexts, such as when a superior bureaucratic organ reviews the regulatory decisions of an inferior bureaucratic organ in a hierarchical system or in political systems with low levels of popular political participation where courts review the decisions of other branches of government. Similarly, the substantive review model may face fewer pressures when the courts involved in judicial review are not independent from the political branches or where their judgments in competition cases can be overridden by higher political organs. In such cases, the judicial determination that the state action in question

⁵⁷ See Lisa Schultz Bressman, 'Beyond Accountability Arbitrariness and Legitimacy in the Administrative State' (2003) 78 NYU L Rev 461, 475–76.

is inconsistent with an organic competition statute is less of an affront to the political branches.

For example, as noted at the outset, the Chinese Antimonopoly Law aims to check unjustified parochial regulations and imposed by provincial and local governments.⁵⁸ Unlike in Europe and the USA, the enforcement scheme does not involve courts overriding the decisions of popularly elected legislators. The scheme provides for correction within the bureaucratic hierarchy. Under Article 51 the offending agency 'shall be ordered by the superior authorities to correct the [abusive] act; the individuals who are directly responsible shall be given a disciplinary sanction [literally, black mark] in accordance with the law'.⁵⁹ The competition agency's authority is quite limited: 'The Anti-monopoly Enforcement Authority may make a proposal to the superior authority to discipline the agency'.⁶⁰ While this scheme may prove overly timid and ineffective at rooting out anticompetitive regulations and obstacles to trade, the substantive review it contemplates does not run into the countermajoritarian problems raised in Western countries.

China is not alone in seeking to deploy competition law principles vertically within a complex bureaucratic or administrative infrastructure. In both developed and developing antitrust jurisdictions, there is often a problem of coordination on competition problems between national and regional political authorities. For example, in India commentators have observed that many of the most stubborn competition problems arise because state governments frequently intervene in markets in anticompetitive ways, for example by favouring dominant suppliers in government procurement policies or practices, explicitly or implicitly encouraging cartelization or bid rigging, or adopting regulatory policies that stifle competition.⁶¹ When a national government seeks to create a broad culture of competition through the adoption of an organic national competition statute, it often faces resistance from regional political forces who, because of cronyism, inertia, or competing regulatory objectives or perspectives are less eager to move toward market openness and competition.

In such cases, the conflict is less between unelected judges and the more politically accountable executive branch than between national and local political institutions. The countermajoritarian difficulty is still present, since local politicians may be more responsive than national ones to local preferences, but it is less stark than in contexts where courts are called upon to employ organic competition law principles to override the regulatory decisions of the elected branches of government. Where senior officials in a political hierarchy scrutinize the decisions of inferior officials to determine whether any impairments of

⁵⁸ See Fox (n 2).

⁵⁹ *ibid* 177.

⁶⁰ *ibid*.

⁶¹ Prabhat Dayal and Manish Agarwal, 'State Government Policies and Competition' in Pradeep S Mehta (ed), *A Functional Competition Policy for India* (Academic Foundation 2006) 111–29.

competition are justified by sound policy objectives, the sorts of difficulties that the US courts were trying to avoid by backing down from substantive due process are less pronounced.

V. Conclusion

State regulations that suppress competition in service of other social, economic, or political objectives have long rankled the competition community. As the competition community expands exponentially around the globe and particularly in places with strong regulatory traditions, the set of state action issues long contested in the USA and Europe will be raised anew. The history of the state action doctrines in the USA and EU suggest that establishing workable and robust measures for judicial review of such state action will not prove easy.

The purpose of this essay has been to provide a stylized, and therefore necessarily incomplete, account of two dominant models of judicial review of anticompetitive action by the state. The attractiveness of either of these models for other jurisdictions will depend on a variety of factors relating to the state's objectives with respect to competition policy, the functions and independence of courts, and other administrative, political, and legal features of the regulatory system. And, of course, these are not the only two possible models. As more states face the thorny issues raised by anticompetitive state regulatory decisions, we should expect to see a variety of new or hybrid models developed.