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Learning to Love the State Action Doctrine

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Abstract The state action doctrine receives relatively little attention in the Federal Trade Commission/Department of Justice 2004 report on competition in the health care sector. Not surprisingly, the report focuses primarily on urging states to reconsider specific laws that tend to restrict competition in health care markets but that are clearly shielded by the state action doctrine. Relatively little attention is given to the interpretation of the doctrine itself. This article employs the twin themes of institutional choice and market failure to evaluate a number of interpretive proposals affecting the state action doctrine that were available to, but not taken up by, the agencies. It also proposes using the state action doctrine to ease the burden on courts in market-failure cases in which there is an obvious threat to competition and the alternative of publicly accountable regulatory action is available.

The Federal Trade Commission and Department of Justice's recent report on health care competition (*Improving Health Care: A Dose of Competition*, 2004) illustrates the complexity of developing and implementing coherent health care competition policy. Making *competition* policy for U.S. markets is difficult because, among other reasons, the antitrust laws—as well as other laws with important competitive consequences—are made and enforced at both the federal and state levels and with the active participation of all three branches of government. Making *health care competition* policy is even more complicated because of the

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special challenges facing health care markets—in particular market failures associated with information, agency, and moral hazard.

The state action doctrine¹ bears a close connection to both of these challenges. The connection between the state action doctrine and institutional choice is obvious. The doctrine prescribes the circumstances under which the regulatory choices of the states warrant deference notwithstanding the congressional policy favoring competition embodied in the antitrust laws. Moreover, although the state action doctrine is technically the product of statutory interpretation, it has been developed and implemented by the federal judiciary. It also affects institutional choice within state government, channeling some decisions to state legislatures and others to courts or administrative agencies.

Perhaps less obviously, the state action doctrine has implications for competition policy's response to health care market failures. State regulation that restricts health care competition is usually justified on the ground that markets do not function efficiently. A common refrain, for example, is that consumers cannot easily evaluate the quality and cost of services they buy in today's health care markets, so regulatory action is needed to guarantee minimum standards. The state action doctrine and its close cousin, antitrust preemption doctrine, establish the parameters under which the antitrust laws, which would otherwise govern under the Constitution's Supremacy Clause, will give way to state judgments in such matters.

Perhaps understandably, the FTC/DOJ report avoids framing its discussion of the state action doctrine in such grand terms and focuses instead primarily on urging states to reconsider specific laws that tend to restrict competition in health care markets but that are clearly shielded by the state action doctrine. Relatively little attention is given to the interpretation of the doctrine itself; the agencies content themselves with observing that the state action doctrine should not be interpreted "in ways that sweep more broadly than necessary to protect the interests of federalism" (FTC/DOJ 2004: Executive Summary [ES], 28; chap. 8, 7–8).

Indeed, the report's rather mild recommendations may reflect the constraints the agencies face as institutions charged primarily with enforcing laws made by others, notably Congress and the courts. Unlike other federal administrative bodies that can expect deference from the judicial branch in the interpretation of their enabling statutes under the *Chevron* doctrine, courts have only rarely deferred to the agencies' interpretation

1. For an overview of the state action and preemption doctrines, including the *Parker-Midcal* framework, see Clark Havighurst's contribution to this issue of *JHPPL*.

of the antitrust laws (Farber and McDonnell 2005: 655–656). While the agencies were comparatively bold in advising state legislatures about what actions should be undertaken to improve health care competition, they were far more hesitant about advising federal courts (and implicitly the U.S. Supreme Court) on “interpretive” issues arising in the case law, and this even though favorable resolution of such issues might have equal, if not greater, effect on the competitiveness of local markets.²

This article employs the twin themes of institutional choice and market failure to evaluate a number of interpretive changes to the state action doctrine that were available to, but not taken up by, the agencies in the report. It also proposes using the state action doctrine to ease the burden on courts in market-failure cases in which there is an obvious threat to competition and the alternative of publicly accountable regulatory action is available.

Roads Not Taken

During the hearings that gave rise to the report, Clark Havighurst (2003: 38) suggested that state legislation conferring unsupervised regulatory authority on incumbent market providers should be viewed as facially preempted by federal antitrust law and hence invalid.³ In essence, Havighurst’s interpretive proposal is about institutional choice: States can either make health care regulatory policy in the legislative branch or they can delegate regulatory decision making to democratically composed agencies. What they may not do under the state action doctrine, Havighurst argues, is to continue the frequent practice of ceding regulatory authority to panels of incumbent providers.

Considering the relatively cautious tone of the report, it is perhaps not surprising that Havighurst’s proposal was not adopted. Indeed, given the long history of provider-controlled professional licensure boards, his suggestion seems a bit shocking. Not only does it not appear to square readily with the existing legal doctrine on facial preemption,⁴ it is entirely at odds

2. The agencies may also have devoted less attention to interpretive issues because of the publication of the FTC State Action Task Force’s report in 2003 (Office of Policy Planning 2003) and because of their ongoing advocacy within the judicial system itself.

3. The other suggestions made by Havighurst in his testimony are dealt with at some length in his contribution to this issue of *JHPPL* and are thus not discussed here.

4. In *Rice v. Norman Williams Co.* (458 U.S. 654 [1982]), the Supreme Court held that “a state statute, when considered in the abstract, may be condemned under the antitrust laws only if it mandates or authorizes conduct that necessarily constitutes a violation of the antitrust laws in all cases, or if it places irresistible pressure on a private party to violate the antitrust laws

with the view of many federal courts that the *Parker-Midcal* clear articulation requirement should be deemed met in cases where it is foreseeable that the agency may regulate in anticompetitive ways (see, e.g., *Crosby v. Hospital Authority*, 93 F.3d 1515 [11th Cir. 1996]).

Despite these objections, a number of well-established antitrust principles support Havighurst's proposal, and many of these seem not to have been taken seriously enough in prior decisions dealing with professional regulation. Consider the following: (1) Federal deference to state regulatory policy is limited to those policies that are genuine policies of the state acting through its politically accountable branches (*FTC v. Ticor Title Insurance*, 504 U.S. 621, 634–635 [1992]). (2) The greater the political accountability of the relevant state decision maker, and the greater the transparency of the relevant decision, the more likely federal law will be to yield ground to state decisions (*Town of Hallie v. City of Eau Claire*, 471 U.S. 34 [1985]). (3) A state policy to “let the incumbents run the market,” even though it presumably is the genuine state policy (i.e., it may be embodied in legislation) has never been sufficient to trump the federal policy in favor of competition (*Patrick v. Burget*, 486 U.S. 94, 100–101 [1988]); Page and Lopatka 1993: 210). (4) States may authorize regulatory regimes that displace competition with regulation, but they cannot simply declare the federal antitrust laws to have no application to markets within their jurisdiction (*Parker v. Brown*, 317 U.S. 341, 351 [1943]). (5) Federal antitrust law almost invariably condemns naked market restraints imposed by provider cartels (Areeda and Hovenkamp 2000: ¶1906a). (6) The dangers posed by giving provider cartels (even those operating as publicly constituted boards) power over market regulation (see Hovenkamp 2000: 181–182) justify a requirement that states adopt the less restrictive alternative of structuring regulation in such a way that the public good rather than private competitive interests are likely to be pursued (183–184; *Allied Tube and Conduit Corp. v. Indian Head*, 486 U.S. 492, 509 [1988]). (7) This does not necessitate any particular structure of state regulation (cf. *Ticor*, 504 U.S. at 639). For example, states might accomplish this goal

in order to comply with the statute. Such condemnation will follow under §1 of the Sherman Act when the conduct contemplated by the statute is in all cases a *per se* violation” (458 U.S. at 661). Other cases indicate that a state statute at odds with federal antitrust law under this sort of ordinary facial preemption analysis may nevertheless be saved from preemption if it passes the ordinary *Parker-Midcal* inquiry; that is, it involves clear articulation by the state of a policy to displace competition with regulation and, if private parties are empowered to impose restraints on competition, their decisions are actively supervised by state officials. Where the challenge involves a particular application of a statute, *only* the *Parker-Midcal* inquiry is required (Areeda and Hovenkamp 2000: ¶217d).

either by including a majority of non–market participant members in the regulatory body or through a structure providing active state supervision or possibly through other means.

Havighurst’s proposal is an obvious improvement over decisions that simply presume that provider-controlled state administrative agencies will make public-regarding decisions in the implementation of state policy. It is also arguably superior to the report’s proposal to subject the decisions of provider-dominated agencies to active supervision. The FTC/DOJ proposal would require judges to engage in a three-step inquiry, first determining whether the state agency is “provider dominated” and, if so, applying the two prongs of the *Parker-Midcal* test. (FTC/DOJ 2004: chap. 8, 7–8). Under Havighurst’s preemption proposal, once a court determined the agency to be provider dominated, the regulatory scheme itself would be preempted, and presumably its rules and adjudications along with it.

Consider, for example, the South Carolina Board of Dentistry’s rules prohibiting dental hygienists from selling their services directly to the public. The FTC has recently alleged that the Board of Dentistry “restrained competition in the provision of preventive dental care services by combining or conspiring with its members or others, or by acting as a combination of its members or others, to restrict unreasonably the ability of dental hygienists to deliver preventive services in school settings” (Complaint at 5, *In the Matter of South Carolina State Board of Dentistry*, Docket No. 9311 [FTC filed Sept. 15, 2003]).⁵ The board’s state action immunity defense includes claims that (1) the board’s rules are themselves state policy and therefore cannot be made the basis of antitrust violations under the state action doctrine, (2) the legislature’s act constituting the board amounts to a clearly articulated state policy to displace competition with regulation because it is foreseeable that the board would take steps that could be characterized as anticompetitive, and (implicitly) (3) the board does not require active supervision (Respondent’s Memorandum in Support of Motion to Dismiss, *In the Matter of South Carolina State Board of Dentistry*, Docket No. 9311 [FTC filed Sept. 15, 2003]).

Under the FTC/DOJ proposal, argument 1 would be foreclosed provided it could be shown that the board was provider dominated.⁶ In order to prevail, however, an antitrust plaintiff would still have to overcome the argument that the board’s conduct was taken pursuant to a clearly articu-

5. This and other documents related to the case are available at www.ftc.gov/os/adjpro/d9311/index.htm.

6. This would be a simple inquiry in the South Carolina case (see Complaint at 2).

lated state policy and prove that the board's decisions were not adequately supervised by state officials. Courts have been disappointingly hesitant to find against state administrative agencies on both these claims (FTC/DOJ 2004: chap. 8, 7–8). If, as appears from the reported cases, courts are unduly hesitant to restrict the anticompetitive activities of provider-dominated boards, the agencies' proposal still leaves the boards with numerous opportunities to avoid a finding of antitrust liability.

Havighurst's proposal, however, would presumably prevent the implementation of many anticompetitive policies in the first place, obviating the need for at least some of the inquiry into the details of state policy. The dental hygienists might defend an action alleging unauthorized practice of dentistry on the basis of preemption, or might even obtain a declaratory judgment that the board's regulation was preempted before any action could be taken against offending hygienists. The prospect that board regulations could simply be disregarded would create a powerful incentive for states to consider providing additional representation on their occupational licensure boards, as some states have indeed already done. On the other hand, legislatures might elect to keep provider-dominated boards in place but add supervision designed to satisfy the second prong of the *Parker-Midcal* test. Given that states are free to permit private trade associations to regulate markets with adequate supervision, this latter sort of arrangement would not be preempted. It would also reopen litigation over the question of active supervision, reducing some, but not all, of the advantages of Havighurst's proposal.

The report likewise ignores Sage and Hammer's (2002) proposal to deal with potentially anticompetitive state regulation by "abandoning the active state supervision requirement of the existing state action doctrine and subjecting both self- and state-regulation to substantive antitrust scrutiny as to their likely effects on market failure" (279). Presumably, their proposal would leave in place the hands-off approach the state action doctrine takes with regard to self-implementing legislation but would (1) subject public agency decisions to antitrust scrutiny for the first time (instead of merely asking whether the legislature had delegated authority to impose potentially anticompetitive regulation), and (2), in the case of privately implemented regulation, replace the oversight by public officials required under current law with limited judicial scrutiny of the competitive merits of the regulations at issue.⁷

7. Sage and Hammer (2002: 279) do not go into detail about what would constitute appropriate judicial "scrutiny as to [privately adopted regulations'] likely effects on market failure."

Unlike the Havighurst proposal, Sage and Hammer's (2002) suggestion involves repudiating (rather than merely distinguishing) a number of important Supreme Court precedents. This fact alone may be part of the reason the report does not mention it. Sage and Hammer offer two well-taken criticisms of the existing state action doctrine: First, from the perspective of competition policy, "it seems inconsistent . . . to subject openly self-regulatory activities to substantive evaluation . . . , while excusing tacitly self-regulatory activities from review if attributable to the state acting in its sovereign capacity." They also observe that the requirement of active state supervision is problematic in the context of professional regulatory bodies because "expert professional activities can seldom be supervised meaningfully" (279).

At bottom, the various proposals for antitrust scrutiny of state regulatory activity represent differing judgments about institutional capacity. The agencies' proposal that the active supervision requirement be read to apply to provider-dominated public agencies may say more about the agencies' institutional constraints than anything else. Their direct recommendation concerning the state action doctrine amounts to a rather modest request that lower courts reconsider their overly permissive treatment of provider-dominated state administrative agencies rather than a rethinking of the judicial approach to the doctrine as a whole.⁸ Elsewhere in the report, however, the agencies urge states to consider broadening the membership of state licensure boards (FTC/DOJ 2004: ES, 22). The agencies thus seem to share Havighurst's reservations about provider-dominated regulatory authorities. Nevertheless, state legislatures are probably far more likely to revisit the issue if they are threatened with antitrust preemption than merely because the agencies have told them that the current system is bad competition policy.

However, they cite Wiley (1986: 743), who would "preempt state and local regulation meeting the following four criteria. First, the regulation restrains market rivalry. Second, the regulation is not protected by a federal antitrust exemption. Third, the regulation does not respond directly to a substantial market inefficiency. . . . Finally, the regulation is the product of capture in the sense that it originated from the decisive political efforts of producers who stand to profit from its competitive restraint." Wiley considers and rejects a rule that "state and local regulation shall not be preempted if accompanied by evidence that the regulatory policymaker consciously and carefully weighed the impact of the regulation on economic efficiency" (744). Sage and Hammer (2002: 280), however, endorse the similar suggestion that "states [could be required to] issue a competition impact statement in connection with particular types of health care regulation." They also suggest that the federal government adopt "comprehensive . . . regulation of competitive conditions in health care, which would at least pre-empt narrow state regulations that can be shown to retard competition primarily to serve private interests" (280).

8. The agencies' recommendation does run afoul of the *Town of Hallie* dictum that "state agencies" should be treated like municipalities and not be deemed to require active supervision (471 U.S. at 46 n.10).

The academics' proposals are much bolder than those of the agencies, but differ in their assessment of the relative competence of federal judges and state officials. Havighurst agrees with the agencies' assessment that courts have done an especially poor job applying the state action doctrine to provider-controlled boards. However, he would invoke the preemption doctrine so as to lessen, not increase, the involvement of (and burdens on) the federal courts (cf. Elhauge 1991: 707–708). Rules adopted by non-provider-controlled bodies pursuant to appropriate legislative authority would continue to generate bright-line immunity. Otherwise, the rules would have no legal effect (and thus would create no shield from liability). Litigation over active supervision in the context of quasi-public agencies would not be necessary. Moreover, preempting rules made by provider-controlled agencies gives legislators (and providers) an incentive to support legislation making existing regulatory bodies more diverse. These bodies, while still potentially subject to regulatory capture, seem at least somewhat more likely to enact public-regarding regulation.

Sage and Hammer's proposal shifts the burden of regulatory supervision from state officials to federal judges and thus involves an implicit judgment that courts are relatively better able to supervise agency rule making than state officials would be. It is conceivable, but by no means certain, that this would be the case. Indeed, one wonders whether some of the latitude that is afforded provider-dominated state rule making is not attributable to federal judges' sense of the difficulty of this task.

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One of the most puzzling features of the report is its failure even to mention the Supreme Court's decision in *California Dental Association v. FTC* (526 U.S. 756 [1999]), in which the Court rejected the "quick look" rule-of-reason approach as insufficient to justify condemnation of restrictions on the advertising of dental prices under circumstances where there was a potentially credible market-failure argument.

Defenders of the *California Dental* holding see the decision as a simple acknowledgment of the reality of market failure in a "post-Chicago" antitrust world, a reality that courts must take into account if they are to develop sensible antitrust policy (Kolasky 1999; Greaney 2004).⁹ Detrac-

9. Other commentators conclude that its importance for general antitrust principles is overstated; for example, see Calkins (2000: 496) (decision is a "reminder of the discomfort with which several members of the Supreme Court view professional advertising [but] teaches little

tors fear that it signals a trend in favor of relaxed antitrust enforcement in cases involving professionals (Havighurst 2001: 949–953),¹⁰ or merely that particularizing antitrust enforcement to any large degree will make antitrust enforcement, especially in health care, too difficult. The opinion is unclear as to whether the Court’s particular skepticism extends only to restraints involving professionals or is directed at any restraint in a market “characterized by striking disparities between the information available to the seller and the buyer” (Hovenkamp 2000: 175 [quoting 526 U.S. at 773]). In either event, it may prove difficult for antitrust plaintiffs to prevail without being put to a full-scale rule-of-reason inquiry in antitrust cases.¹¹

At the very least, *California Dental* is an expression of the Supreme Court’s optimism about the relative competence of the federal judiciary to assess claims of market failure in connection with concerted decision making of health care professionals. This arguably represents a shift from earlier cases involving professionals, in which the Court was a good bit more modest (some might say circumspect) about its capacities for case-by-case assessment of market performance.¹²

The state action doctrine suggests an avenue through which antitrust

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about more general antitrust issues”); and Muris (2000) (arguing that decision reflects complexities of professional advertising but that different result would obtain in the case of similar non-professional restraints).

10. For example, Hovenkamp 2000: 174 (noting the possibility that *California Dental* “may even signal a return to an era in which the so-called ‘learned professions’ were given deference that has been denied to them in recent years”).

11. With respect to the latter point, consider Lawrence Sullivan’s (1995: 680) assessment of the role of antitrust courts in sorting through competing “post-Chicago” arguments: “For a court with a post-Chicago concept of antitrust economics, far more issues will be for juries than for courts. In any situation bringing post-Chicago analyses into collision, the role of the trier of fact . . . is to decide which of the competing explanations . . . is the most convincing. . . . Does this story take into account all of the facts? If there are facts it does not account for, do they tend to confound it? Is it consistent with human motivations in general? With particular motivations demonstrated by evidence to be significant in this particular instance?” This seems dangerously close to a return to the days that Justice Stephen Breyer warned of in his dissent in *California Dental* when enforcers “had to present and/or refute every possible fact and theory, [preventing cases] from ever reaching a conclusion” (526 U.S. at 794).

12. “If a decision is to be made to sacrifice competition in one portion of the economy for greater competition in another portion this too is a decision that must be made by Congress and not by private forces or by the courts. Private forces are too keenly aware of their own interests in making such decisions and courts are ill-equipped and ill-situated for such decision making. To analyze, interpret, and evaluate the myriad of competing interests and the endless data that would surely be brought to bear on such decisions, and to make the delicate judgment on the relative values to society of competitive areas of the economy, the judgment of the elected representatives of the people is required” (*United States v. Topco Associates*, 405 U.S. 596, 611–612 [1972]).

courts can acknowledge both the complexities of health care markets and their own institutional limitations in dealing with them. *California Dental* expresses the Court's understandable hesitation about simply assuming, given the likelihood of information problems in health care markets, that professional services markets are functioning well. The Court seems determined to acknowledge the reality that such markets are subject to failure and the possibility that corrective action, even when undertaken by private parties, could make things better in a second-best world. It appears to some observers, however, that having faced up to the reality of market failure, the Court is in denial as to the limitations of the judicial branch.

Given the apparent ease with which market failure can be argued in the case of professional services and the apparent difficulty of distinguishing good arguments from bad ones, antitrust courts should refuse to credit market-failure arguments offered to justify horizontal restraints that would pose an obvious potential danger to competition in a well-functioning market, especially where professional organizations are involved.¹³ In essence, this would require professional organizations to take their market-failure arguments to state legislatures or public regulatory agencies and seek shelter under the state action doctrine. Restraints imposed by politically unaccountable and financially interested private parties, particularly restraints that on their face potentially deserve per se condemnation (as was the case in *California Dental*), should be greeted in court with skepticism. Restraints enacted in the public political process will sometimes be just as economically pernicious, but can be passed over on the basis of the state action doctrine without the need for the judiciary (or, worse yet, a jury) to form an assessment about their merit or demerit on the basis of economic theory. In either case, courts can dispose of the case more expeditiously and make judgments that are more likely to be within their institutional capacities.¹⁴

The advantages of this proposal are perhaps most clearly seen from the vantage point of the relative costs imposed on private actors who want to impose self-serving restraints of trade.¹⁵ Consider the situation of a private

13. For example, restraints that could tend to make price competition more difficult preclude lower-cost services from being offered by a competing group of providers or otherwise raise barriers to entry into the market.

14. This proposal assumes that politically accountable state authorities that are not dominated by market incumbents will do no worse a job than judges and juries in sorting through economic evidence about the existence of market failure and the appropriateness of proposed cures for it. The more latitude courts give to defendants to offer economic justifications for facially restrictive practices, the more plausible this assumption becomes.

15. Cf. Elhauge (1991: 728 n. 289); Macey (1988: 494–505).

trade association or professional organization wishing to implement a horizontal restraint that will benefit its membership but harm consumers. The organization may be able to institute the restraint with a minimum of publicity, and the restraint may not be easily detected by consumers or antitrust enforcers. Whether legal action will be taken against it in response to the restraint depends upon a number of factors, including whether private victims can overcome collective-action problems, institutional and political constraints on public antitrust enforcement, the cost of bringing the action, and the likelihood of success in the event the action is brought.

Eliminating or reducing judicial openness to market-failure arguments in the aforementioned circumstances increases the cost of implementing harmful restraints. It increases the likelihood that legal action will be taken against the conspirators by increasing the plaintiffs' chances of success (eliminating a potential defense) and reducing the plaintiffs' cost of litigation. Competitors who determine that legal action against them is likely enough to constitute a deterrent must seek its implementation, if at all, through more public political processes.¹⁶

It might be objected that refusing to admit market-failure arguments under these circumstances not only reduces the prospects for restraints that benefit the implementing competitors, but likewise increases the costliness of implementing restraints of trade that would benefit consumers by improving market performance. The likelihood that this will be the case could be reduced somewhat by refusing to countenance market-failure arguments only in cases where the restraint would pose a clear risk to competition in a well-functioning market.

More importantly, however, one might consider who should bear the burden of invoking governmental processes in connection with privately implemented restraints that pose obvious threats to competition. Closing off market-failure defenses in the circumstances described tends to shift the burden from the public (whether private plaintiffs or enforcement officials) to the competitors seeking to implement the restraint. Placing the burden on the competitors makes sense for a variety of reasons. First, it is probably reasonable to assume that obviously dangerous restraints imposed by unaccountable private interests in the name of market failure or similar justifications will tend to injure consumers at least as often as they help them. In this case, it seems sensible to put the burden of seek-

16. The proposed interpretation also has the advantage of maintaining the administrability of antitrust law and sending a clearer signal about the illegality of privately implemented restraints.

ing governmental action on the conspirators rather than on their victims (Elhauge 1991: 713). Second, economic theory suggests that organized groups of competitors tend to fare well (perhaps too well) in the political process (Olson 1965). Third, placing the burden on competitors to seek advance approval for obviously dangerous restraints saves the public the economic injuries that occur between the implementation of the restraint and its termination through public processes (Elhauge 1991: 714).

In an age where economic theory is increasingly more attentive to the failures of markets than to their successes, and in an industry that is thought to have more than its share of market problems, there is the perennial danger that antitrust law will become unworkable, to the detriment of courts, consumers, and even competitors trying to assess the legality of proposed courses of action. Moreover, an otherwise laudable judicial zeal to respect our federal constitutional structure has occasionally transformed the state action doctrine into a blank check for state legislative concessions to rent-seeking private parties. The state action doctrine has a role to play in assuring that the best available institution decides whether market imperfections exist and what, if anything, should be done about them.

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