ANTITRUST IMMUNITY UP IN SMOKE: PREEMPTION, STATE ACTION, AND THE MASTER SETTLEMENT AGREEMENT

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In antitrust law, the state action doctrine allows states to take regulatory actions that would otherwise result in violations of the federal antitrust laws. Unfortunately, the Supreme Court has not always provided clear guidance in its state action jurisprudence, and lower courts have expressed frustration with this doctrinally confusing area of antitrust law. There is confusion among the lower courts over the relationship between state action immunity and the related doctrine of federal antitrust preemption. Further, lower courts are confused as to how they should apply the Midcal *two-pronged test regulating the availability of state action immunity to private actors. The judicial response to antitrust suits over the tobacco Master Settlement Agreement (MSA), a settlement signed between tobacco manufacturers and forty-six states, provides a stark example of this confusion. The Second and Third Circuits have held that the antitrust preemption and state action doctrines do not immunize the MSA from charges of facilitating a price-fixing conspiracy among cigarette makers, while five other circuits have held the contrary. This Note explores the MSA circuit split and contends that the Second and Third Circuits were correct in holding that antitrust preemption and state action immunity do not shield the MSA. This result is consistent with Supreme Court precedent and antitrust policy.*

INTRODUCTION

The federal antitrust laws, particularly the Sherman Act, are "the Magna Carta of free enterprise."[1] They regulate various business practices based on the likelihood that those practices harm consumers by reducing economic efficiency.[2] These laws target private actors.[3] Sometimes, state regulation of business also has anticompetitive effects that harm consumers. The state action doctrine allows a state to take these

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1. United States v. Topco Assocs., Inc., 405 U.S. 596, 610 (1972).

2. See 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, 270 (2003) ("[T]he Supreme Court has developed a complicated set of antitrust categories, prescribing forms and levels of scrutiny of various practices, based upon their likelihood of harming consumers by reducing economic efficiency.").

3. See Herbert Hovenkamp, The Antitrust Enterprise: Principle and Execution 13 (2005) ("The antitrust laws are concerned with maintaining competition in private markets.").

regulatory actions that would otherwise be illegal under the antitrust laws.[4] The Supreme Court created the state action doctrine in 1943 in *Parker v. Brown*.[5] Since *Parker*, the Supreme Court has handed down approximately fifteen decisions refining and clarifying the state action doctrine, and the lower federal courts have applied the doctrine hundreds of times.[6] Perhaps most importantly, in 1980 in *California Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc.*, the Court announced that to gain state action immunity, a private defendant must show that (1) the challenged conduct is "'one clearly articulated and affirmatively expressed as state policy'"; and (2) the policy is "'actively supervised'" by the state itself.[7]

Unfortunately, the Supreme Court has not always provided clear guidance in its state action jurisprudence, and lower courts have expressed frustration with this "doctrinally confusing" area of antitrust law.[8] Courts have encountered two general problems in this area. First, there is confusion in lower courts over the relationship between *Parker* state action immunity and the related doctrine of federal antitrust preemption. In general, a federal law may preempt a state statute where Congress expressly precludes the application of state law, where federal law "occupies the field" and leaves no room for states to supplement, or where a direct conflict exists between federal and state law such that it is impossible to comply with both.[9] The Supreme Court has held that federal antitrust law preempts a state statute only if it is per se illegal: The statute must "necessarily constitute[] a violation of the antitrust laws in all cases, or [must place] irresistible pressure on a private party to violate the antitrust laws in order to comply with the statute."[10]

Second, courts applying the state action doctrine are confused as to whether a party seeking state action immunity must prove the *Midcal* factors (clear articulation and active supervision) to be shielded by the doctrine. The judicial response to antitrust suits over the tobacco Master Settlement Agreement (MSA), a settlement signed between tobacco manufacturers and forty-six states, provides a stark example of this confusion. The Second and Third Circuits have held that the antitrust preemp-

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4. See Section of Antitrust Law, Am. Bar Ass'n, State Action Practice Manual 1 (2000) [hereinafter ABA State Action Practice Manual] ("The state action doctrine is a set of judicially created rules that determine whether the federal antitrust laws apply to particular anticompetitive interstate commercial conduct or whether a state's regulatory actions will remove the particular conduct from federal antitrust scrutiny.").

5. 317 U.S. 341 (1943).

6. ABA State Action Practice Manual, supra note 4, at ix.

7. 445 U.S. 97, 105 (1980) (quoting City of Lafayette v. La. Power & Light Co., 435 U.S. 389, 410 (1978) (plurality opinion)).

8. Costco Wholesale Corp. v. Maleng, 522 F.3d 874, 887–88 (9th Cir. 2008).

9. ABA State Action Practice Manual, supra note 4, at 78–79.

10. Rice v. Norman Williams Co., 458 U.S. 654, 661 (1982). For an explanation of per se illegality in antitrust law, see infra notes 58–63 and accompanying text.

tion and state action doctrines do not immunize the MSA from charges of facilitating a price-fixing conspiracy among cigarette makers, while five other circuits have held the contrary.[11]

This Note investigates the conflicting judicial responses to the MSA and argues that the Second and Third Circuits were correct in holding that the antitrust preemption and state action doctrines did not shield the MSA. This approach is more consistent with Supreme Court precedent and antitrust policy. This Note explains that the circuits take different approaches to antitrust preemption: The Fifth, Sixth, Eighth, Ninth, and Tenth Circuits held that, to be preempted, a state statute must explicitly *authorize* or *mandate* per se illegal behavior,[12] while the Second and Third Circuits found preemption if a state statute *pressures* or *incentivizes* private parties to engage in per se illegal behavior.[13] This Note then argues that Supreme Court precedent and policy concerns support the Second and Third Circuit's approach: A statute that creates strong incentives to commit a per se antitrust violation, though it may not explicitly require them, should be preempted by the Sherman Act.

This Note further contends that the Second and Third Circuits were correct in holding that the MSA was not shielded by state action immunity. The circuits took varying approaches to state action immunity: The Eighth and Ninth Circuits found the alleged antitrust injury was a sovereign act of the state, and therefore state action immunity automatically

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11. See infra Part II.C–D (describing differences among circuits considering MSA).

12. See S&M Brands, Inc. v. Caldwell, 614 F.3d 172, 177 (5th Cir. 2010) (holding no antitrust preemption because anticompetitive behavior at issue resulted from behavior of cigarette manufacturers after MSA implementation and was not mandated or authorized by MSA); Grand River Enters. Six Nations v. Beebe, 574 F.3d 929, 937 (8th Cir. 2009) ("Although the statute in question places some pressure on [cigarette manufacturers] to charge higher prices to offset the escrow payments, this pressure does not force [manufacturers] to raise prices 'in all cases.'" (quoting Rice v. Norman Williams Co., 458 U.S. 654, 661 (1982))); KT&G Corp. v. Att'y Gen., 535 F.3d 1114, 1130 (10th Cir. 2008) ("[T]he statute, on it [sic] face, does not mandate or authorize conduct that is a per se violation of the Sherman Act in all cases."); Sanders v. Brown, 504 F.3d 903, 911 (9th Cir. 2007) ("Sanders therefore has failed to adequately allege that the implementing statutes mandate or authorize conduct that 'in all cases' violates federal antitrust law. The implementing statutes are thus not preempted by the Sherman Act." (citation omitted) (quoting Fisher v. City of Berkeley, 475 U.S. 260, 265 (1986))); Tritent Int'l Corp. v. Kentucky, 467 F.3d 547, 557 (6th Cir. 2006) (holding no antitrust preemption because anticompetitive behavior at issue resulted from behavior of cigarette manufacturers after MSA implementation and was not mandated or authorized by MSA).

13. See Freedom Holdings, Inc. v. Spitzer, 357 F.3d 205, 225–26 (2d Cir. 2004) ("As alleged, the MSA . . . created substantial disincentives for any PM to attempt to increase its market share through price competition. . . . We therefore hold that appellants have sufficiently alleged a *per se* violation of the Sherman Act."); A.D. Bedell Wholesale Co. v. Philip Morris Inc., 263 F.3d 239, 248 (3d Cir. 2001) ("Plaintiffs allege the agreement between the States and the Majors purposefully creates powerful disincentives to increase cigarette production. . . . For this reason, signatories have an incentive to raise prices to match increases by competitors.").

applied;[14] however, the Second and Third Circuits held that, because the alleged antitrust injury resulted from private firm actions subsequent to the MSA's implementation, the *Midcal* clear articulation and active supervision tests had to be met before immunity could apply.[15] This Note argues that Supreme Court precedent as well as policy concerns support the Second and Third Circuits' approach in this regard as well; courts applying the state action doctrine should more carefully consider the source of antitrust injury and rely less on formalistic labels.

Part I reviews the Supreme Court's development of the state action doctrine and the related concept of antitrust preemption and summarizes the current law in these areas. Part II describes the MSA, academic commentary on its antitrust impact, and the conflicting judicial responses to antitrust claims against the MSA. Part III evaluates the circuits' differing approaches to antitrust immunity. It proposes that (1) in evaluating preemption claims, courts should consider whether a statute creates strong incentives to commit a per se antitrust violation; and (2) in considering whether the *Midcal* factors must be applied to gain state action immunity, courts should pay renewed attention to the source of antitrust injury. This Note concludes that while there may be good policy reasons to protect the MSA from liability, courts should evaluate the MSA in a way that does the least violence to antitrust immunity doctrine.

I. THE STATE ACTION DOCTRINE AND ANTITRUST PREEMPTION

Part I.A describes the origins and development of the antitrust state action doctrine. Part I.B describes the related doctrine of antitrust preemption. Part I.C summarizes the current state of the law in this area.

A. *Origins and Development of the State Action Doctrine*

Part I.A.1 discusses the foundational *Parker* decision. For the purposes of this Note, the most important Supreme Court decisions follow-

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14. *Grand River*, 574 F.3d at 941 ("The State of Arkansas entered into the MSA and legislatively enacted the Allocable Share Amendment. Thus, we hold that *Parker* 'state action' immunity applies." (citing Parker v. Brown, 317 U.S. 341, 350–51 (1943))); *Sanders*, 504 F.3d at 918 ("Since the California attorney general's act of entering into the MSA is a sovereign act, as are the legislature's actions in enacting the Qualifying Act and Contraband Amendment, the state is immune from antitrust liability for these actions . . . .").

15. *Freedom Holdings*, 357 F.3d at 226 ("That is, if a state statute mandates or authorizes *per se* violations of the antitrust laws, it will be saved from preemption only if (i) the restraint in question is 'clearly articulated and affirmatively expressed as state policy,' and (ii) the policy is 'actively supervised' by the State itself." (quoting Cal. Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc., 445 U.S. 97, 105 (1980))); *A.D. Bedell*, 263 F.3d at 258 ("[T]hese acts by the governmental parties were not the direct source of the anticompetitive injuries. . . . [T]he anticompetitive injury here resulted from the tobacco companies' conduct after implementation of the Multistate Settlement Agreement, and not from any further positive action by the States." (footnote omitted)).

ing *Parker* are *Midcal*[16] and *Hoover*,[17] which explain what antitrust defendants must show to gain state action immunity. Part I.A.2 and Part I.A.3 explore *Midcal* and *Hoover*, respectively.

1. Parker v. Brown. — California's Agricultural Prorate Act established state programs to prevent the marketing "of greater quantities of agricultural commodities than are reasonably necessary to supply the demands of the market."[18] Under the Act, the state set up a program that limited raisin output and thereby raised the price of raisins.[19] Plaintiff, a producer of raisins in California, challenged the validity of the program as a violation of the Sherman Act.[20] The Supreme Court assumed (though it did not decide) that the program would have violated the Sherman Act had it been organized solely by an agreement among private actors.[21]

The Court held that the California program was immune from federal antitrust scrutiny, however, because it was created and implemented by the state.[22] The Court explained that the Sherman Act is a prohibition of "individual and not state action."[23] The Court based this holding on a review of the text and history of the Sherman Act, which revealed no evidence that the Act was intended to apply to states.[24]

The *Parker* Court noted, however, that mere approval by the state would not immunize all potential anticompetitive conduct: States may not "give immunity to those who violate the Sherman Act by authorizing them to violate it, or by declaring that their action is lawful."[25] But the Court did not elaborate on what conduct fell outside the state action doctrine's protection, and the Court did not thoroughly explore the limits of the doctrine until a series of cases in the 1980s.

2. Midcal. — In *California Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc.*, the Court provided some guidance, in the form of a two-part test, to determine whether a state's actions suffice to immunize oth-

16. *Midcal*, 445 U.S. at 97.

17. Hoover v. Ronwin, 466 U.S. 558 (1984).

18. Ch. 754, § 1, 1933 Cal. Stat. 1969, 1969.

19. Antitrust Modernization Comm'n, Report and Recommendations 343 (2007), available at http://govinfo.library.unt.edu/amc/report_recommendation/amc_final_report.pdf (on file with the *Columbia Law Review*).

20. Parker v. Brown, 317 U.S. 341, 344, 349 (1943).

21. Id. at 350.

22. Id. ("[The program] derived its authority and its efficacy from the legislative command of the state and was not intended to operate or become effective without that command.").

23. Id. at 352.

24. See id. at 350–51 (finding "nothing in the language of the Sherman Act or in its history which suggests that its purpose was to restrain a state or its officers or agents from activities directed by its legislature"); see also id. at 351 (holding Act's legislative history indicates purpose "to suppress combinations to restrain competition and attempts to monopolize by *individuals and corporations*" (emphasis added)).

25. Id.

erwise anticompetitive conduct from federal antitrust scrutiny.[26] In *Midcal*, the Court considered another California statute: one that forbade wine wholesalers from selling wine at any price below the minimum set by wine producers.[27] The Court held that the wine pricing system was a form of resale price maintenance, which at the time was per se illegal under the Sherman Act.[28] The Court then had to decide whether *Parker* protected the wine pricing system.[29]

The *Midcal* Court found that the wine pricing system was not protected from antitrust scrutiny by the state action doctrine.[30] The Court announced a two-pronged test to determine whether the state action doctrine applies: "First, the challenged restraint must be 'one clearly articulated and affirmatively expressed as state policy'; second, the policy must be 'actively supervised' by the State itself."[31] The statute at issue satisfied the "clear articulation" prong of the test, as the "legislative policy is forthrightly stated and clear in its purpose to permit resale price maintenance."[32] But the restraint failed the "active supervision" prong of the test. The state merely authorized price-setting by private parties; it did not set the prices itself, and it did not review the prices for reasonableness.[33]

Midcal's two-pronged test was a critically important development in the state action doctrine. It declared that states could not merely rubberstamp the anticompetitive behavior of private parties. Indeed, the *Midcal* Court noted that "[t]he national policy in favor of competition cannot be thwarted by casting such a gauzy cloak of state involvement over what is essentially a private price-fixing arrangement."[34] If states wish to displace the federal antitrust law, they must replace it with some regulatory oversight. Philip Areeda and Herbert Hovenkamp have argued that federalism considerations require a distinction between state regulation and unsupervised conduct by private parties:

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26. 445 U.S. 97 (1980).

27. Id. at 99–100.

28. Id. at 102–03 ("This Court has ruled consistently that resale price maintenance illegally restrains trade. . . . California's system for wine pricing plainly constitutes resale price maintenance in violation of the Sherman Act."). In Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 551 U.S. 877, 907 (2007), the Supreme Court struck down the per se rule against minimum resale price maintenance and held such restraints should be judged by the rule of reason. See infra notes 58–63 and accompanying text for an explanation of per se rules and the rule of reason in antitrust law.

29. 445 U.S. at 103.

30. Id. at 105 ("The program, however, does not meet the second requirement for *Parker* immunity.").

31. Id. (quoting City of Lafayette v. La. Power & Light Co., 435 U.S. 389, 410 (1978) (plurality opinion)).

32. Id.

33. Id. at 105–06.

34. Id. at 106.

> The concerns of federalism require yielding to state regulatory prerogatives but not to the possibly anticompetitive market decisions of private firms. . . . [U]nder our principles of federalism . . . the state has significant power to displace the federal antitrust laws and substitute *its own* regulatory judgments. But the state does not have the power simply to displace the federal antitrust laws and then abandon the market at issue to the unsupervised discretion of private participants.[35]

3. Hoover v. Ronwin. — In *Hoover*, the Court held that the *Midcal* two-pronged test is inapplicable in situations where the antitrust violation is caused by the state acting *as a sovereign*. In such a case, the *Parker* state action doctrine automatically protects the defendant from antitrust liability; the defendant need not show clear articulation or active supervision.[36] *Hoover* involved admission to the Arizona bar. The Arizona Supreme Court controlled a committee comprised of practicing lawyers who established grading standards for the bar exam.[37] The plaintiff sued the committee, claiming that—in violation of the Sherman Act—it had manipulated the grading standards to limit the number of competing attorneys in Arizona.[38]

The critical issue in the case was determining the relevant antitrust actor—was the challenged conduct undertaken by the Arizona court itself, with the committee as its agent, or was it undertaken by the committee, independent of the court? In *Hoover*, the U.S. Supreme Court held that the challenged conduct was in reality carried out by the Arizona Supreme Court.[39] The Arizona court maintained "strict supervisory powers and ultimate full authority" over the committee's decisions.[40] Though the committee set the grade curve, it did so subject to rules promulgated by the Arizona court, and the Arizona court made the final decision to grant or deny admission to the bar.[41]

The finding that the Arizona Supreme Court, rather than the committee, was the relevant actor proved to be dispositive. In *Hoover*, the U.S. Supreme Court declared that when the challenged conduct is the act of the state legislature or state supreme court, the *Midcal* two-pronged test is inapplicable.[42] *Midcal*'s two-pronged test is applicable only when a

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35. 1A Philip E. Areeda & Herbert Hovenkamp, Antitrust Law ¶ 226, at 163–64 (3d ed. 2006).

36. See Hoover v. Ronwin, 466 U.S. 558, 569 (1984) ("Where the conduct at issue is in fact that of the state legislature or supreme court, we need not address the issues of 'clear articulation' and 'active supervision.'").

37. Id. at 561–62.

38. Id. at 565.

39. Id. at 573.

40. Id. at 572.

41. Id. at 572–73.

42. Id. at 569.

"nonsovereign state representative" undertakes the challenged conduct.[43] In such cases, the *Midcal* factors allow courts to be sure that the state actually contemplated the anticompetitive conduct of that nonsovereign state representative.[44] But when the sovereign itself takes the action, "the danger of unauthorized [anticompetitive conduct] does not arise."[45]

Justice Stevens, dissenting in *Hoover*, agreed with the majority that if the Arizona Supreme Court had imposed the restraint, it would be immune from the antitrust laws.[46] In his view, however, the Arizona Supreme Court was not the relevant decisionmaker.[47] The conduct at issue was the committee's alleged decision to limit the number of attorneys admitted to practice in Arizona by raising grading standards.[48] The Arizona Supreme Court neither directed the committee to artificially limit the number of admitted lawyers nor set the grading standards for the bar.[49] Thus, the restraint was the work of the committee alone, and the committee could not shield itself with the Arizona Supreme Court's sovereign antitrust immunity.[50] Instead, in Justice Stevens's opinion, the majority should have evaluated the conduct according to *Midcal*'s two-pronged test.[51] The interplay between the majority and dissent in *Hoover* highlights the difficulty of distinguishing between public and private actors for the purpose of applying the state action doctrine.

B. *Antitrust Preemption—Unilateral and Hybrid Restraints*

As the U.S. Supreme Court fleshed out the *Parker* state action doctrine in *Midcal* and *Hoover*, it also developed the distinct but related doctrine of federal antitrust preemption. In general, a federal law may preempt a state statute where (1) Congress expressly precludes the application of state law; (2) federal law "occupies the field" and leaves no room for states to supplement; or (3) a direct conflict exists between federal and state law such that it is impossible to comply with both.[52] The relationship between preemption in the antitrust context and the state

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43. Id.

44. Id at 568–69.

45. Id. at 569.

46. Id. at 588 (Stevens, J., dissenting).

47. Id. at 588–89.

48. Id. at 588.

49. Id.

50. Id. at 592.

51. See id. at 596 ("The alleged conspiracy to introduce a factor other than competence into the bar examination process is not the product of a clearly articulated and affirmatively expressed state policy and hence does not qualify for antitrust immunity.").

52. ABA State Action Practice Manual, supra note 4, at 79; see, e.g., Fisher v. City of Berkeley, 475 U.S. 260, 263 (1986) (involving claim that city ordinance was "unconstitutional because [it was] pre-empted by the federal antitrust laws"); see also infra Part I.B.2 for further discussion of *Fisher*.

action doctrine is a confusing one, as the discussion below shows.[53] However, understanding antitrust preemption analysis is critical to understanding when the state action doctrine might be applied to immunize anticompetitive conduct and to understanding the confusion among lower courts in the MSA context. The major Supreme Court cases in this area are *Rice v. Norman Williams Co.*[54] and *Fisher v. City of Berkeley.*[55] Part I.B.1 and Part I.B.2 review *Rice* and *Fisher*, respectively.

1. Rice v. Norman Williams Co. — The *Rice* decision set forth the rule that federal antitrust law preempts a state statute only if the state statute mandates or authorizes conduct that causes an antitrust violation "in all cases"; in other words, the conduct must be a per se violation.[56] Further, the decision explored the relationship between antitrust preemption and state action. The *Rice* Court held that if federal antitrust law does not preempt a state statute, then that state statute is automatically immune from antitrust challenge. In other words, a defendant does not then need to use the state action doctrine to defend against the antitrust claim.[57]

The antitrust concepts of "per se" rules and "rules of reason" are important in preemption analysis. A per se rule treats certain categories of anticompetitive conduct as "necessarily illegal" under the antitrust laws without considering the reasonableness of the conduct "in light of the real market forces at work."[58] By contrast, under the "rule of reason," a factfinder will weigh "'all of the circumstances of a case in deciding whether a restrictive practice should be prohibited as imposing an unreasonable restraint on competition.'"[59] The rule of reason is designed to distinguish between "restraints with anticompetitive effect that are harmful to the consumer and restraints stimulating competition that are in the consumer's best interest."[60] The rule of reason is essentially the default rule in determining whether a given practice violates the Sherman Act.[61] Per se rules are exceptional and are only applied to restraints "'that would always or almost always tend to restrict competition and decrease

53. Accord Snake River Valley Elec. Ass'n v. PacifiCorp, 238 F.3d 1189, 1192 n.8 (9th Cir. 2001) ("The Court has not clearly defined the relationship between federal antitrust preemption of state laws restricting competition and the state action immunity doctrine.").

54. 458 U.S. 654 (1982).

55. 475 U.S. 260.

56. 458 U.S. at 661.

57. See id. at 662 n.9 ("Because of our resolution of the pre-emption issue, it is not necessary for us to consider whether the statute may be saved from invalidation under the doctrine of *Parker v. Brown* . . . .").

58. Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 551 U.S. 877, 886 (2007).

59. Id. at 885 (quoting Cont'l T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 49 (1977)).

60. Id. at 886.

61. Id. at 885.

output.'"[62] Restraints that receive per se treatment include agreements among competitors to fix prices or to divide markets.[63] The concept of a per se antitrust violation was critical to the Court's decision in *Rice*.

At issue in *Rice* was a California statute that made it illegal for a liquor distributor to import any brand of liquor into the state, unless the brand owner had designated the distributor an "authorized importer."[64] The plaintiffs argued, and the California Court of Appeal agreed, that the designation statute conflicted with the Sherman Act on its face, because it would result in all cases in a per se violation of the Act.[65]

The U.S. Supreme Court reversed, holding that the designation statute was not preempted by the Sherman Act. In any preemption case, the Court looks for an irreconcilable conflict between federal and state regulatory schemes; a hypothetical or potential conflict is insufficient to warrant the preemption of the state statute.[66] In the antitrust context, this means that a statute is preempted only if it "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 in order to comply with the statute."[67] To be a violation "in all cases," the statute must result in a per se violation:

> [Preemption] will follow under § 1 of the Sherman Act when the conduct contemplated by the statute is in all cases a per se violation. If the activity addressed by the statute does not fall into that category, and therefore must be analyzed under the rule of reason, the statute cannot be condemned in the abstract. Analysis under the rule of reason requires an examination of the circumstances underlying a particular economic practice, and therefore does not lend itself to a conclusion that a statute is facially inconsistent with federal antitrust laws.[68]

In *Rice*, the Court found that the challenged statute was essentially a vertical nonprice restraint.[69] Such restraints are subject to the rule of rea-

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62. Id. at 886 (quoting Bus. Elecs. Corp. v. Sharp Elecs. Corp., 485 U.S. 717, 723 (1988)).

63. Id.

64. Rice v. Norman Williams Co., 458 U.S. 654, 657–58 (1982).

65. Id.

66. Id. at 659.

67. Id. at 661.

68. Id.

69. Generally, a vertical restraint is "imposed by persons or firms that are above the restrained person or firm in the chain of distribution." Assam Drug Co. v. Miller Brewing Co., 798 F.2d 311, 314 (8th Cir. 1986). A vertical *nonprice* restraint limits "the territories within which a distributor or retailer may resell the manufacturer's product (a 'territorial' restriction), the place or places of business from which the buyer may resell (a 'location' restriction), or the types of customers to whom the buyer may resell (a 'customer' restriction)." Mark E. Roszkowski, The Sad Legacy of *GTE Sylvania* and Its "Rule of Reason": The Dealer Termination Cases and the Demise of Section 1 of the Sherman Act, 22 Conn. L. Rev. 129, 131 (1989).

son.[70] Thus, there was no basis for "condemning the statute itself by force of the Sherman Act."[71]

The *Rice* Court then briefly considered the applicability of the state action doctrine. It said in a footnote that, because it had resolved the preemption issue, "it is not necessary for us to consider whether the statute may be saved from invalidation under the doctrine of *Parker v. Brown*."[72] This suggests the analysis is sequential.[73] If the plaintiff brings a facial challenge to a state statute, the court should first consider whether the statute is preempted by the Sherman Act. If the statute appears preempted, then the state action doctrine could still save it from being struck down.[74]

2. Fisher v. City of Berkeley. — *Fisher* further developed antitrust preemption doctrine by identifying the categories of state regulatory schemes that could be preempted by the federal antitrust laws. The decision also provided guidance on the relationship between state action and antitrust preemption.

The City of Berkeley enacted a city ordinance (the "Ordinance") setting the maximum rent landlords could charge.[75] A group of landlords owning rental property in Berkeley brought suit claiming that the Ordinance facially conflicted with the Sherman Act and therefore was preempted.[76]

The U.S. Supreme Court held that the federal antitrust laws did not preempt the Ordinance.[77] The Court conceded that a voluntary agreement among Berkeley's landlords to stabilize rent would constitute an antitrust violation, even though such an agreement would have the same economic effect as the Ordinance.[78] The Court noted, however, a distinction in the statutory scheme between "unilateral conduct" and "con-

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70. See *Rice*, 458 U.S. at 661 ("We held in *GTE Sylvania* that a manufacturer's use of vertical nonprice restraints is not *per se* illegal. Because restraints on intrabrand competition may promote interbrand competition, we concluded that non-price vertical restraints should be scrutinized under the rule of reason." (citing Cont'l T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 57–59 (1977))).

71. Id. at 662.

72. Id. at 662 n.9 (citing Parker v. Brown, 317 U.S. 341 (1943)).

73. See 1 Areeda & Hovenkamp, supra note 35, ¶ 217b2, at 360 ("[T]he Court was not yet obliged, in this 'facial' attack on the state statute, to apply the further test that the *Midcal* statute had failed—namely, whether the state adequately supervised the private power it had created.").

74. See id. ¶ 217d, at 372 ("The Court was speaking simply of successive steps in preemption analysis. In sum, if the state statute appears to be preempted under *Rice* because it creates serious restraints, it can nevertheless be saved from preemption by satisfying *Parker*.").

75. Fisher v. City of Berkeley, 475 U.S. 260, 262 (1986).

76. Id. at 264.

77. Id. at 270.

78. Id. at 266.

certed conduct."[79] Section 1 of the Sherman Act requires a "contract, combination . . . , or conspiracy" in restraint of trade.[80] So, to prove a conflict with section 1, plaintiffs have to show some agreement, or "concerted action," among distinct parties.[81] Plaintiffs argued that the Ordinance formed an agreement between the city and the landlords, or, alternatively, among the landlords.[82] The Court rejected these theories by explaining that the relationship between the city and the landlords was not an agreement, but the result of the government coercing citizens to obey the law:

> A restraint imposed unilaterally by government does not become concerted-action within the meaning of the statute simply because it has a coercive effect upon parties who must obey the law. The ordinary relationship between the government and those who must obey its regulatory commands whether they wish to or not is not enough to establish a conspiracy.[83]

In sum, a unilateral restraint cannot be preempted by the Sherman Act, because mere compliance with a state statute does not violate section 1. Thus, the Court did not "need [to] address whether, even if the controls were to mandate § 1 violations, they would be exempt under the state-action doctrine from antitrust scrutiny."[84]

This result should be troubling, since in *Midcal* the Supreme Court had struck down a state statute that required private firms to engage in resale price maintenance and thus to commit a per se violation of the antitrust laws. There was no concerted action among private parties in *Midcal*; the private actors in that case behaved anticompetitively because state law required them to do so. Under the logic of *Fisher*, then, the statute at issue in *Midcal* would have been upheld as a unilateral restraint—an exercise of the state's power to coerce citizens to obey the law.

The *Fisher* Court recognized this tension with *Midcal*, and conceded "[n]ot all restraints imposed upon private actors by government units necessarily constitute unilateral action outside the purview of § 1."[85] A regulatory scheme may be attacked under the Sherman Act if the restraint is a "hybrid" one.[86] A hybrid restraint is one that has granted private actors "'a degree of private regulatory power'" and uses state mech-

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79. Id.

80. Id. (quoting 15 U.S.C. § 1 (1982) ("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.")).

81. Id. at 267 ("Thus, if the Berkeley Ordinance stabilizes rents without this element of concerted action, the program it establishes cannot run afoul of § 1.").

82. Id.

83. Id.

84. Id. at 270.

85. Id. at 267.

86. Id. at 267–68.

anisms to "merely enforce private marketing decisions."[87] The scheme at issue in *Midcal* is an example of a hybrid restraint.[88] There the relevant statute granted a "degree of regulatory power" to the wine producers by allowing them to fix resale prices without any oversight or regulation by the state.[89] Because of this space of unregulated activity, "the mere existence of legal compulsion did not turn California's scheme into unilateral action by the State."[90] In contrast Berkeley's rent control statute placed "complete control over maximum rent levels exclusively in the hands of the [government]."[91] In sum, if a state regulatory scheme can be characterized as a unilateral restraint, it is not preempted by federal antitrust law. If it can be characterized as a hybrid restraint, however, it is vulnerable to preemption.[92]

Finally, the *Fisher* Court addressed the relationship between antitrust preemption and the state action doctrine:

> Legislation that would otherwise be pre-empted under *Rice* may nonetheless survive if it is found to be state action immune from antitrust scrutiny under *Parker v. Brown*. . . . [W]e cannot say that the Ordinance is facially inconsistent with the federal antitrust laws. We therefore need not address whether, even if the controls were to mandate § 1 violations, they would be exempt under the state-action doctrine from antitrust scrutiny.[93]

This language emphasizes that the analysis is sequential: A statute that appears preempted under *Rice* and *Fisher* may still be valid if it passes *Midcal*'s two-pronged state action test.[94] In contrast, a statute that is not preempted under *Rice* and *Fisher* is immune from antitrust challenge; *Parker* state action immunity applies without further inquiry.

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87. Id. (quoting and citing Rice v. Norman Williams Co., 458 U.S. 654, 665, 666 n.1 (1982)).

88. Id. at 268.

89. Id. at 269.

90. Id.

91. Id.

92. Commentators have argued that the *Fisher* Court was misleading in its focus on the presence or absence of an agreement and that the keys to the preemption analysis are the distinction between hybrid and unilateral restraints and the question of whether the state has left private parties to make unregulated pricing decisions. See 1 Areeda & Hovenkamp, supra note 35, ¶ 217b2, at 362 n.49 ("Although [*Fisher*] . . . seemed to emphasize the absence of any agreement with or among private parties in finding no preemption, the Ninth Circuit [in Miller v. Hedlund, 813 F.2d 1344, 1349–50 (9th Cir. 1986)] correctly saw that the essence of *Fisher* was public supervision of private pricing decisions."); id. ¶ 217b3, at 364.

93. 475 U.S. at 265, 270 (citations omitted).

94. See 1 Areeda & Hovenkamp, supra note 35, ¶ 217b3, at 365 ("[S]tatutes failing to survive the first-level preemption inquiry of *Rice* can nevertheless be saved from preemption if they pass the two-pronged *Parker* test as summarized in *Midcal* . . . .").

C. *Reconciling State Action and Preemption*

Part I.C.1 summarizes the law regarding antitrust immunity for state regulatory schemes; Part I.C.2 considers some potential sources of confusion in Supreme Court precedent. While the state action and preemption inquiries are not identical, they overlap in substantial ways. And, as illustrated by the cases above, the Supreme Court has not always "provided clear guidance in defining the relationship between the 'hybrid' restraint inquiry and the *Midcal* 'active supervision' inquiry" in this "doctrinally confusing area."[95]

1. *Summary.* — Part I.C.1.a summarizes the steps a court would take in evaluating antitrust preemption; Part I.C.1.b summarizes the steps a court would take in evaluating antitrust state action.

a. *Preemption.* — At the outset, the court should determine whether preemption analysis is applicable. Preemption analysis is only applicable when a plaintiff is challenging the validity of a statute.[96] However, a plaintiff might not be challenging the statute itself. Rather, the plaintiff may claim that the state statute, while valid on its face, has caused conduct resulting in an antitrust injury. In that case, the court will not apply preemption analysis, but will skip ahead to the state action analysis, described in Part I.C.1.b below.[97]

If preemption analysis is appropriate, it proceeds as follows. *Rice* teaches that for a statute to be preempted, it must mandate, authorize, or place "irresistible pressure on a private party" to engage in conduct that is "in all cases a per se violation."[98] State statutes are not preempted if they only cause private parties to violate the antitrust laws in some hypothetical situation.[99] Further, if the statute contemplates a rule of reason violation, such as the statute in *Rice*, then it does not violate the antitrust laws in all cases and cannot be the basis for a preemption claim.[100]

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95. Costco Wholesale Corp. v. Maleng, 522 F.3d 874, 887–88 (9th Cir. 2008).

96. See 1 Areeda & Hovenkamp, supra note 35, ¶ 217d, at 373 ("[C]ourts talk in more explicit preemption terms when the statute itself is challenged—for example, . . . where the statute is attacked 'on its face' independently of specific violations.").

97. Areeda and Hovenkamp describe how a claim of antitrust injury removes the need for preemption analysis:

> [C]ourts applying *Parker* do not usually speak in preemption terms, but that is easily explained. Most of the cases implicating that decision charge either a government subdivision or a private party with an *antitrust violation*. The defendant then asserts that some statute or other government action shields or "exempts" it from antitrust liability. Usually taking the non-preempted validity of the governing statute for granted[,] . . . the court then examines its implications with the two-prong inquiry codified by *Midcal* to see whether the *challenged behavior* is appropriately authorized and supervised.

Id. (emphasis added).

98. Rice v. Norman Williams Co., 458 U.S. 654, 661 (1982).

99. 1 Areeda & Hovenkamp, supra note 35, ¶ 217b2, at 359.

100. *Rice*, 458 U.S. at 661–62.

If the court finds that the state's regulatory scheme mandates a per se violation, the court then distinguishes between unilateral restraints and hybrid restraints. *Fisher* teaches that a hybrid restraint is a state regulatory scheme that leaves private actors "'a degree of private regulatory power.'"[101] As a concrete example, *Fisher* points to the statute in *Midcal*,[102] which not only gave resale prices the force of law, but also gave private actors the unsupervised discretion to set those prices.[103]

b. *State Action.* — If the court finds that the state regulatory scheme creates a unilateral restraint, then the analysis is complete: The state regulatory scheme is valid and not preempted by federal antitrust law. The defendant does not have to argue that the state regulatory scheme fulfills the requirements of *Midcal*'s two-pronged test; *Parker* state action immunity applies without further inquiry.[104] If, however, the court finds that the state regulatory scheme creates a hybrid restraint, then a further step is needed to obtain immunity. The defendant has to show that the state regulatory scheme passes *Midcal*'s two-pronged test of clear articulation and active state supervision.[105]

Finally, to conduct the state action analysis, the court will determine who caused or imposed the relevant anticompetitive conduct. *Hoover* teaches that if the state itself is the relevant actor, the conduct is immune without further analysis.[106] If, however, the private party acting in conjunction with the state is the relevant actor, then, before granting state action immunity, the court must determine whether that private actor is adequately authorized and supervised by the state under *Midcal*.[107]

2. *Overlap and Distinctions Between State Action and Preemption.* — In attempting to synthesize preemption and state action, courts and scholars have expressed the view that the preemption and state action immunity

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101. Fisher v. City of Berkeley, 475 U.S. 260, 268 (1986) (quoting *Rice*, 458 U.S. at 666 n.1 (Stevens, J., concurring)).

102. Id. at 268–69.

103. See supra notes 27–28, 33 and accompanying text (discussing statute at issue in *Midcal* and lack of state supervision); see also Lopatka & Page, supra note 2, at 284 (reasoning that restraints move from unilateral to hybrid when "private participation in a state-sponsored decision-making process crosses some critical threshold of similarity to established antitrust prohibitions").

104. See *Fisher*, 475 U.S. at 270 ("[The Ordinance] lack[s] the element of concerted action needed before [it] can be characterized as a per se violation of § 1 of the Sherman Act . . . . [We] need not address whether . . . [it] would be exempt under the state-action doctrine from antitrust scrutiny." (citation omitted)); Costco Wholesale Corp. v. Maleng, 522 F.3d 874, 887 (9th Cir. 2008) ("[O]nce we determine that a restraint is unilaterally imposed by the state as sovereign, *Parker* immunity applies without further inquiry.").

105. *Costco*, 522 F.3d at 877 ("*Parker* immunity applies to the hybrid restraint only if it satisfies the two-part *Midcal* inquiry.").

106. Hoover v. Ronwin, 466 U.S. 558, 569 (1984).

107. Id.

doctrines substantially overlap and effectively merge with each other.[108] Areeda and Hovenkamp argue that "the 'state action' exemption from the antitrust laws simply expresses the conclusion that certain state laws are not preempted. The *Midcal-Rice-Fisher* [preemption] inquiry and the *Parker* [state action] inquiry are fundamentally consistent but sequential."[109]

This is not to say, however, that the state action and preemption inquiries are exactly the same. There are distinctions, and the Supreme Court has not always made those distinctions clear. In *Costco Wholesale Corp. v. Maleng*, the Ninth Circuit noted that the *Midcal* Court "treated the issues of preemption and immunity as essentially the same inquiry" while the *Rice* and *Fisher* Courts "drew a fine line between the inquiries."[110] Areeda and Hovenkamp recognize this phenomenon more generally—"courts applying *Parker* do not usually speak in preemption terms."[111]

Areeda and Hovenkamp attribute this to a difference between facial challenges to a statute on the one hand and challenges to particular applications of a statute on the other. Most cases applying state action involve challenges to the particular application of a statute. Such challenges charge a government subdivision or private party with a violation of the antitrust laws; they typically take the non-preempted validity of the governing statute for granted and instead argue that the behavior *arising under* the statute fails the *Midcal* two-pronged test.[112] In contrast, courts bring up preemption when a plaintiff challenges the statute itself, for example, when there is no private violation, when an injunction is sought to prevent enforcement of the statute, or when the statute is attacked "on its face" regardless of any specific antitrust violations.[113]

To evaluate antitrust challenges to the tobacco Master Settlement Agreement, the lower federal courts had to apply this confusing body of

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108. See *Costco*, 522 F.3d at 887 ("We believe that in this case—and many others—there is such substantial overlap between the active supervision and hybrid inquiries that they effectively merge."); Merrick B. Garland, Antitrust and State Action: Economic Efficiency and the Political Process, 96 Yale L.J. 486, 507 (1987) ("There are signs that the *Fisher* Court understood the way in which its preemption analysis collapses into the *Midcal* test.").

109. 1 Areeda & Hovenkamp, supra note 35, ¶ 217d, at 370. The description of *Midcal* as a preemption case is initially confusing; it is explained by Areeda and Hovenkamp's reading of *Midcal* as addressing preemption and state action simultaneously. See id. ¶ 217b1, at 358 (observing *Midcal* two-pronged test determines both whether state statute is preempted and whether state statute is saved by *Parker* state action doctrine).

110. 522 F.3d at 887.

111. 1 Areeda & Hovenkamp, supra note 35, ¶ 217d, at 373.

112. Id.

113. Id.; see also id. ¶ 217d, at 371 ("[H]olding a state statute to be preempted by federal law does not in itself mean that anyone is guilty of violating the antitrust laws. . . . Preemption removes one shield that the defendants might have; it does not itself create the offense.").

law. It is not surprising, then, that they arrived at very different results in evaluating essentially the same claims and the same factual situation. The next Part describes the MSA and the varied judicial pronouncements on its immunity to antitrust challenges.

II. THE MASTER SETTLEMENT AGREEMENT AND ANTITRUST IMMUNITY

Part II.A describes the background and functioning of the Master Settlement Agreement (MSA). Part II.B describes the generally critical response of economists and antitrust scholars to the MSA. Part II.C and Part II.D describe the circuit split regarding the antitrust liability of the MSA.

A. *Understanding the Master Settlement Agreement*

Part II.A.1 provides background on the MSA. Part II.A.2 describes the payments cigarette manufacturers must make to the states under the MSA. Part II.A.3 describes state statutes that ensure the states do not lose revenue due to increased competition among manufacturers.

1. *Background.* — In 1998, the attorneys general of forty-six states (the Settling States) signed the MSA with the four largest tobacco companies in the United States. The MSA settled various state suits to recover the costs of treating smoking-related illnesses.[114] To recover these costs, the MSA requires payments by the settling tobacco companies to the states.[115] In exchange for the payments, the MSA releases participating tobacco manufacturers from liability for a broad range of state claims for their past and future conduct.[116] The payments, and the state statutes designed to ensure their receipt, are the source of antitrust challenges to the MSA.

2. *Payment Structure.* — The MSA was initially executed by the four dominant cigarette manufacturers: Philip Morris, Lorillard Tobacco, Brown & Williamson, and R.J. Reynolds.[117] The MSA calls these four firms the "Original Participating Manufacturers," or "OPMs."[118] The OPMs are required to make annual payments to the states in perpetu-

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114. Tobacco, National Association Attorneys General, http://www.naag.org/tobacco.php (on file with the *Columbia Law Review*) (last visited Oct. 19, 2012). For further background on the MSA and the history of tobacco litigation, see generally Shital A. Patel, The Tobacco Litigation Merry-Go-Round: Did the MSA Make It Stop?, 8 DePaul J. Health Care L. 615 (2005).

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

116. Master Settlement Agreement Between Settling States and Brown & Williamson, Lorillard Tobacco, Philip Morris & R.J. Reynolds et al., §§ II(nn)–(pp), XII (Nov. 23, 2008) [hereinafter MSA], available at http://www.naag.org/backpages/naag/tobacco/msa/msa-pdf/MSA%20with%20Sig%20Pages%20and%20Exhibits.pdf/download (on file with the *Columbia Law Review*).

117. *Freedom Holdings*, 357 F.3d at 210.

118. MSA, supra note 116, § II(hh).

ity.[119] The OPMs' overall annual payment obligation is specified in the MSA. The overall payments started at $4.5 billion in 2000 and climb to a maximum of $9 billion in 2018 and every year thereafter.[120] This overall obligation is allocated among individual OPMs based on their relative market shares from the previous year.[121]

The OPMs anticipated raising cigarette prices to help pay for the settlement and feared that smaller manufacturers not part of the negotiations would cut into the OPMs' market share by selling cheaper cigarettes.[122] The settling parties tried to protect the OPMs from competition in three ways: volume adjustments, encouragement of nonparticipating manufacturers to join the MSA, and reduction of OPM payments if the OPMs lost sales to nonparticipating manufacturers.

First, as for volume adjustments, if total OPM production falls below an agreed-upon level, the overall payment obligation of the OPMs will fall accordingly.[123] Second, the MSA encourages non-OPM cigarette producers to sign the MSA. "Subsequent Participating Manufacturers," or "SPMs," are non-OPMs that have signed the MSA.[124] An SPM does not have to make any payments to the states, so long as its market share does not increase beyond a prescribed level.[125] If an SPM's market share exceeds the prescribed level, it has to pay a portion of the OPMs' overall payment obligation, based on the excess market share.[126] This arrangement protects the OPMs by deterring SPMs from gaining market share, or by compensating the OPMs with lower payments if the SPMs gain market share anyway.[127] Third, the MSA allows for a reduction in OPM payments if participating manufacturers (OPMs and SPMs) lose market share because of price competition from a Nonparticipating

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119. Id. § IX(c)(1).

120. Id.

121. Id. §§ II(z), IX(c)(1). For example, if an OPM produced twenty-five percent of the cigarettes produced by all the OPMs in a given year, the OPM would have to pay twenty-five percent of the overall payment in the following year.

122. Sanders v. Brown, 504 F.3d 903, 907 (9th Cir. 2007).

123. MSA, supra note 116, exhibit E ("In the event the Actual Volume [the aggregate number of cigarettes sold by the OPMs in the United States] is less than the Base Volume [approximately 476 billion cigarettes] . . . [t]he Applicable Base Payment shall be reduced . . . .").

124. Id. § II(tt).

125. An SPM does not have to make any payments to the states, unless its market share exceeds the greater of its 1998 market share or 125% of its 1997 market share. Id. § IX(i)(1). Market share is defined as an SPM's share of the total number of cigarettes sold in the United States. Id. § II(z).

126. Id. § IX(i)(2).

127. Martha A. Derthick, Up in Smoke: From Legislation to Litigation in Tobacco Politics 177 (2012) ("[SPMs] . . . were given a subsidy in return for accepting a prescribed market share. This arrangement freed the largest companies from a fear that raising prices cooperatively would cause them to lose share to small firms (and, if they did lose share, their payments were more than proportionately reduced).").

Manufacturer, or "NPM"—any tobacco product manufacturer that does not agree to the MSA.[128]

3. *Protecting State Revenues.* — In the framework above, the states may lose revenues due to increased NPM competition. States can prevent this problem by enacting a "Qualifying Statute" that will immunize them from downward NPM adjustments.[129] Qualifying Statutes require NPMs to join the MSA or pay a per-unit amount into an escrow account.[130] The amount of the escrow payments is set in such a way as to erase the cost advantage for NPMs who do not participate in the MSA.[131]

Further, many states have enacted Contraband Statutes to enforce their Qualifying Statutes.[132] These statutes make it illegal for NPMs to sell cigarettes in a Settling State without first complying with the Qualifying Statute. For example, New York's Contraband Statutes require manufacturers to certify that they are in compliance with the state's Qualifying Statute before their cigarettes can get a New York state cigarette tax stamp.[133] Any cigarettes without the tax stamp may be confiscated.[134] The ultimate effect of the Qualifying and Contraband Statutes is to force every nonparticipating cigarette manufacturer to join the MSA as an SPM, and thus be subject to its market share restrictions or face large fines.

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128. MSA, supra note 116, §§ II(cc), (jj). To trigger this reduction (known as "the NPM adjustment"), the participating manufacturers as a whole must lose market share and an economic consulting firm must determine that the MSA was "a significant factor" contributing to the loss. Id. § IX(d)(1)(C), at 61. The payment obligation is reduced based on the amount of market share loss. Id. § IX (d)(1)(A).

129. The MSA defines a Qualifying Statute as one "that effectively and fully neutralizes the cost disadvantages that the Participating Manufacturers experience vis-à-vis Non-Participating Manufacturers within such Settling State as a result of the provisions of this Agreement." Id. § IX(d)(2)(E), at 65. If the state has a Qualifying Statute on the books, its Allocated Payment is not subject to an NPM Adjustment. Id. § IX(d)(2)(B), at 63. An "Allocated Payment" is a particular state's share of the OPM payment obligation. Id. § II(g).

130. The MSA includes a model Qualifying Statute. Id. exhibit T. The model statute requires any tobacco product manufacturer selling tobacco products within the state to either (1) join the MSA or (2) pay a per-unit amount into a state escrow fund. Id. exhibit T, at T-3 to T-4. Every Settling State has enacted a Qualifying Statute, also known as an "Escrow Statute." Freedom Holdings, Inc. v. Spitzer, 357 F.3d 205, 212 (2d Cir. 2004).

131. The amount of escrow payments is capped at the state's allocable share of the amount the NPM would have paid had it been an SPM in the MSA. MSA, supra note 116, exhibit T, at T-4 to T-5. Thus, the effect of the Qualifying Statute is to erase the cost advantage of an NPM who chooses not to participate in the MSA. Sanders v. Brown, 504 F.3d 903, 908 (9th Cir. 2007).

132. See Grand River Enters. Six Nations v. King, No. 02 CIV.5068 JFK, 2008 WL 4615838, at *1 (S.D.N.Y. Oct. 14, 2008) ("Many states also enacted 'Contraband Statutes,' which deny manufacturers that do not comply with the Escrow Statutes a tax stamp, essentially prohibiting the sale of their cigarettes.").

133. N.Y. Tax Law § 480-b (McKinney 2006).

134. N.Y. Tax Law § 1846 (McKinney 2004).

B. *The Economic and Legal Effects of the MSA*

Part II.B.1 reviews the economics literature on the MSA. Part II.B.2 reviews the legal scholarship on the MSA. Academic commentators have generally reacted negatively to the MSA from an antitrust standpoint. They argue that the MSA constitutes a price-fixing cartel that is per se illegal under the antitrust laws and that the MSA has had a collusive effect in the cigarette industry. This background informs the analysis of the MSA circuit split.

1. *Economics Perspectives.* — Federico Ciliberto and Nicolai V. Kuminoff conducted an empirical study of the MSA's impact on the nature of competition in the cigarette industry.[135] They found that the MSA payments effectively raised the federal per-pack tax on cigarettes by $0.44, but that cigarette firms raised prices by more than $1 in the first few years following the agreement.[136] They explain this difference by showing that the MSA provided an opportunity for cigarette firms to agree to collectively raise prices.[137]

Ian Ayres described the MSA as a "legal innovation in cartelization technology."[138] By "[m]aking damages contingent on future quantities sold," the MSA increases the "manufacturers' marginal cost and therefore can predictably increase the price toward the monopoly level."[139] Further, by "[e]xempting a certain number of units produced (the 'offset' amount) from the damage calculation," the MSA enables the state to share the cartel profits with cigarette manufacturers.[140] To Ayres, the bottom line was that the MSA would anticompetitively raise market prices toward the monopoly level and deter new entry.[141]

2. *Antitrust Law Perspectives.* — Antitrust scholars have been generally critical of the MSA. Areeda and Hovenkamp describe the MSA as a "naked" restraint and an "unsupervised cartel agreement" because "it was not accompanied by any integration of production or development, and

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135. Federico Ciliberto & Nicolai V. Kuminoff, Public Policy and Market Competition: How the Master Settlement Agreement Changed the Cigarette Industry, 10 B.E. J. Econ. Analysis & Pol'y, no. 1, art. 63, 2010, at 1.

136. Id.

137. See id. at 39 ("Overall, our results support the hypothesis that the Master Settlement Agreement acted as a coordinating device for firms to collectively end their price war and raise cigarette prices.").

138. Ian Ayres, Using Tort Settlements to Cartelize, 34 Val. U. L. Rev. 595, 595 (2000).

139. Id. at 596; see also Jeremy Bulow, Profiting from Smokers, 69 S. Econ. J. 736, 739–40 (2003) ("[T]he payments are still probably illegal for antitrust reasons. . . . After each settlement the marginal costs of every firm would rise by the same amount, leading immediately to a similar increase in prices and causing consumers to have to pay off the firms' liabilities.").

140. Ayres, supra note 138, at 596.

141. Id. at 595.

because the state did not supervise the resulting output or pricing decisions."[142]

Michael S. Greve surveyed antitrust enforcement by state attorneys general and found that state antitrust enforcers are generally unwilling to use the antitrust laws to challenge actions by other states.[143] As an example of these "coordinated state enforcement campaigns," Greve points to the MSA.[144] He argues that the MSA "is not a metaphorical cartel, or a state cartel in the sheep's clothing of policy coordination; *it is the actual wolf.*"[145]

Todd Zywicki and Joshua C. Wright submitted an amicus brief supporting Supreme Court review of the MSA's antitrust immunity:

> As predicted by economic theory, the MSA dampens the incentive for price competition by the Majors against the subsidized smaller manufacturers, resulting in stabilized market shares, increased industry profits, and price increases much larger than justified by the increase in costs or predicted under competitive conditions. The MSA and the escrow statutes combine to ensure a national cigarette cartel. Economic theory accurately predicts corresponding welfare transfers from consumers to the tobacco industry and states through higher profits and tax increases.[146]

C. *Cases Finding the MSA Vulnerable to Antitrust Enforcement*

Given the problems outlined in Part II.B above, it did not take long for NPMs and wholesalers to challenge the MSA under the antitrust laws.[147] Part II.C.1 and Part II.C.2 review the Second and Third Circuit rulings in *Freedom Holdings* and *A.D. Bedell*, which found that antitrust preemption and the state action doctrine do not protect the MSA from antitrust challenge.

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142. 1 Areeda & Hovenkamp, supra note 35, ¶ 217b4, at 367; see also Thomas C. O'Brien, Constitutional and Antitrust Violations of the Multistate Tobacco Settlement, 371 Pol'y Analysis 1, 10 (2000), available at http://www.cato.org/pubs/pas/pa371.pdf (on file with the *Columbia Law Review*) ("[The MSA is] effectuated through a system of collusive cost sharing, price fixing, and exclusion of competitors agreed to in the MSA. Unquestionably, the officers of private companies attempting to implement such a scheme would go to jail and pay substantial fines under the Sherman Antitrust Act.").

143. Michael S. Greve, Cartel Federalism? Antitrust Enforcement by State Attorneys General, 72 U. Chi. L. Rev. 99, 101–02 (2005).

144. Id. at 121.

145. Id. at 121–22 (emphasis added).

146. Brief for Antitrust Law Professors as Amici Curiae in Support of Petitioners at 12, S&M Brands, Inc. v. Caldwell, 614 F.3d 172 (5th Cir. 2010) (No. 10-622), available at http://cei.org/sites/default/files/S%20Ct%20%20Antitrust%20Amicus.pdf (on file with the *Columbia Law Review*).

147. Plaintiffs have brought a number of non-antitrust claims against the MSA as well. See, e.g., Freedom Holdings, Inc. v. Spitzer, 357 F.3d 205, 209 (2d Cir. 2004) (describing Commerce Clause and Equal Protection Clause claims); Michael S. Greve, Compacts, Cartels, and Congressional Consent, 68 Mo. L. Rev. 285, 289 (2003) (arguing Compact Clause requires congressional consent for state agreements such as MSA).

1. *Third Circuit:* A.D. Bedell. — In *A.D. Bedell Wholesale Co. v. Philip Morris Inc.*, a class of cigarette wholesalers sued the OPMs, seeking damages and a permanent injunction against the MSA.[148] The plaintiffs claimed that the MSA created "severe obstacles to market entry, or to increasing production and market share."[149] Allegedly, these obstacles allowed the OPMs to raise prices to "near monopoly levels."[150] The OPMs responded that the *Parker* doctrine immunized the MSA.[151] The district court granted a motion to dismiss, finding that the tobacco companies were immune from antitrust liability under *Parker*.[152]

In analyzing the *Parker* state action issue, the Third Circuit considered whether the *Midcal* two-pronged test applied to the state's actions. The court began by gesturing in the direction of *Hoover*, noting that *Midcal*'s test is unnecessary if the "antitrust injury was the *direct result* of a clear sovereign state act."[153] The court raised the possibility of finding direct involvement of state legislatures and executives, which would automatically result in immunity and foreclose *Midcal*'s application.[154] But the court then retreated from this view, focusing "not on the negotiation and consummation of the Multistate Settlement Agreement, but on *its actual operation and resulting effects, since that is the true cause of the anticompetitive effects*. This is how the Supreme Court analyzed the behavior in *Midcal*."[155]

The critical issue to the Third Circuit was the source of the actions that resulted in antitrust injury. If the anticompetitive injury was caused

148. 263 F.3d 239, 241 (3d Cir. 2001). The wholesalers bought cigarettes directly from the OPMs. Id. ("Bedell, as a wholesaler, bought directly from the Majors.").

149. Id. at 246.

150. Id. ("Because output is restricted and because of the inelastic demand for cigarettes, in part due to their addictive nature, the Multistate Settlement Agreement allegedly permitted the Majors to raise their prices to near monopoly levels[—]levels allegedly above those necessary to fund the settlement payments." (footnote omitted)).

151. Id. at 249. The plaintiffs also challenged the MSA under the *Noerr-Pennington* doctrine, which creates antitrust immunity for parties who petition the government for anticompetitive policies. Cf. Cal. Motor Transp. Co. v. Trucking Unlimited, 404 U.S. 508, 510 (1972) (declaring no antitrust liability for "mere attempts to influence the Legislative Branch for the passage of laws or the Executive Branch for their enforcement"). In *A.D. Bedell*, the Third Circuit upheld the district court's finding of immunity for the MSA under *Noerr-Pennington*. 263 F.3d at 254 ("Freedom from the threat of antitrust liability should apply to settlement agreements as it does to other more traditional petitioning activities.").

152. *A.D. Bedell*, 263 F.3d at 241.

153. Id. at 256.

154. See id. at 256–57 (noting "[a]n argument can be made that the Multistate Settlement Agreement, and any of its anticompetitive effects, were the direct result of state government action" and describing involvement of state executive officials, Attorneys General, and state legislatures).

155. Id. at 257 (emphasis added).

by the government, it was not necessary to apply *Midcal*.[156] If, on the other hand, the anticompetitive injury was caused by a private party, the *Midcal* two-pronged test was applicable.[157] In *A.D. Bedell*, the court found that the actions of state governments in setting up the MSA did not cause the alleged antitrust injury.[158] Rather, the alleged injury resulted from the tobacco companies' conduct after MSA implementation, conduct that consisted of taking advantage of the MSA's structure to raise prices to supracompetitive levels.[159] Though the court was conducting a *Parker-Midcal* state action analysis, it borrowed a page from the book of preemption analysis and compared the MSA to a "hybrid" restraint as defined in *Rice* and *Fisher*.[160] It used this comparison to support application of the *Midcal* two-pronged test.[161]

The court then applied the *Midcal* two-pronged test to the MSA. It found that the MSA satisfied the clear articulation requirement but not the active supervision requirement.[162] In finding no active supervision, the court reasoned that

> [t]he States here are actively involved in the maintenance of the scheme, but they lack oversight or authority over the tobacco manufacturers' prices and production levels. These decisions are left entirely to the private actors. Nothing in the Multistate Settlement Agreement or its Qualifying Statutes gives the States authority to object if the tobacco companies raise their prices.[163]

Thus, the Third Circuit found that the MSA is not immune under the state action doctrine.

2. *Second Circuit:* Freedom Holdings. — In *Freedom Holdings, Inc. v. Spitzer*, the plaintiffs were a class of companies that imported cigarettes into New York from foreign manufacturers and were not parties to the

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156. Cf. id. at 258 ("[D]irect state action, without *Midcal* analysis, [is found] only when the allegedly anticompetitive behavior was the direct result of acts within the traditional sovereign powers of the state.").

157. See id. (noting unless private party caused anticompetitive injury, there is "no need to apply the *Midcal* analysis").

158. See id. ("Although the Multistate Settlement Agreement was a negotiated settlement by State Attorneys General, and the state legislatures were responsible for passing the Qualifying Statutes to enforce important components of the agreement, these acts by the governmental parties were not the direct source of the anticompetitive injuries.").

159. See id. ("[J]ust as the injury in *Midcal* was caused by private parties taking advantage of the state imposed market structure, the anticompetitive injury here resulted from the tobacco companies' conduct after implementation of the Multistate Settlement Agreement, and not from any further positive action by the States.").

160. See id. at 258 ("[T]his case resembles a 'hybrid restraint' as discussed by Justice Stevens in his concurrence in *Rice* . . . ." (quoting Rice v. Norman Williams Co., 458 U.S. 654, 666–67 (1982) (Stevens, J., concurring))).

161. See id. ("Hybrid restraints are not the type of sovereign state action . . . that avoid *Midcal* treatment. Instead, hybrid restraints involve a degree of private action which calls for *Midcal* analysis.").

162. Id. at 265.

163. Id. at 264.

MSA.[164] They sought an injunction to stop enforcement of the New York Contraband Statute and filed suit against New York state government officials with responsibility to enforce that statute.[165] In effect, they wanted "to sell cigarettes in New York outside the scheme created by the MSA and enforced by the Contraband Statutes."[166] The plaintiffs brought a facial challenge against the Contraband Statutes, claiming that they conflicted with section 1 of the Sherman Act and were therefore preempted.[167] The district court granted a motion to dismiss, holding that the state action doctrine immunized the Contraband Statutes from violating the antitrust laws.[168]

The Second Circuit reversed the application of state action immunity, holding that the Contraband Statutes were preempted by the Sherman Act.[169] The court applied the *Rice* standard, requiring the plaintiffs to show that the Contraband Statutes would constitute a per se violation if brought about by an agreement among private parties.[170] The defendants argued there could be no per se violation in this case because the Sherman Act required private agreement and this case concerned a unilateral act of the state.[171] The court rejected this argument and held that the plaintiffs did not have to show a private agreement to prove the MSA was a per se violation; they instead had to show it was a hybrid restraint that granted a degree of private regulatory power.[172]

The court then found that the MSA and Contraband Statutes would constitute a per se Sherman Act violation if done by private agreement.[173] Horizontal agreements to fix prices, divide markets, or restrict output are per se illegal.[174] And the plaintiffs alleged that the MSA forced partici-

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164. 357 F.3d 205, 208 (2d Cir. 2004).

165. Id. at 208, 215. The Contraband Statutes require cigarette manufacturers to join the MSA or make escrow payments under the Escrow Statute to legally sell cigarettes within the state. Id. at 213–14; see supra Part II.A.3 for further discussion of the MSA and accompanying statutes.

166. 357 F.3d at 215.

167. Id. at 222.

168. Id. at 209.

169. Id.

170. See id. at 222 ("A statute will be preempted . . . 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 in order to comply with the statute.'" (quoting Rice v. Norman Williams Co., 458 U.S. 654, 661 (1982))).

171. Id. at 223.

172. See id. ("Where the anticompetitive effects of a state statute obviate the need for private parties to act on their own to create an anticompetitive scheme, the statute may be attacked as a 'hybrid' restraint on trade."); see also supra note 92 (discussing *Fisher*). The *Freedom Holdings* court also noted that even if the defendants' argument was correct as a matter of law, the MSA constituted an express agreement among the OPMs, and so a private agreement could be found. 357 F.3d at 224.

173. 357 F.3d at 226.

174. Id. at 225.

pants to divide markets and fix prices by penalizing increases in market share.[175] Thus, the court found that the plaintiffs alleged a "naked restraint on competition" that is per se illegal.[176] The court also approvingly cited *A.D. Bedell*'s holding that the MSA was a hybrid restraint because "'the [MSA] empower[ed] the tobacco companies to make anticompetitive decisions with no regulatory oversight by the States.'"[177] Thus, under *Fisher* and *Rice*, the court concluded that the MSA is preempted by the Sherman Act.

The *Freedom Holdings* court then considered whether state action, specifically the *Midcal* clear articulation and active supervision test, could save the MSA from preemption.[178] Like in *A.D. Bedell*, the court found that the MSA failed *Midcal*'s active supervision test.[179] Therefore, *Parker* state action immunity did not save the Contraband Statutes from preemption.[180]

D. *Cases Finding the MSA Immune from Antitrust Enforcement*

Not all courts presented with the question of the MSA's antitrust immunity found the MSA vulnerable to antitrust enforcement. Part II.D.1 examines the Ninth Circuit's holding in *Sanders v. Brown*, which broke with the Second and Third Circuits and found that the MSA was

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175. Market share increases are penalized by the MSA's provisions requiring increased payments to the states. Id. Thus, plaintiffs alleged that the OPMs were free to raise prices; confident competitors would also raise prices to avoid increasing their market share. Id.

176. Id. at 226. The court concluded:

> Had the executives of the major tobacco companies entered into such an arrangement without the involvement of the States and their attorneys general, those executives would long ago have had depressing conversations with their attorneys about the United States Sentencing Guidelines. We therefore hold that appellants have sufficiently alleged a *per se* violation of the Sherman Act.

Id. (citation omitted).

177. Id. at 225 (quoting A.D. Bedell Wholesale Co. v. Philip Morris Inc., 263 F.3d 239, 260 (3d Cir. 2001)).

178. See id. at 226–32 ("That is, if a state statute mandates or authorizes per se violations of the antitrust laws, it will be saved from preemption only if (i) the restraint in question is '"clearly articulated and affirmatively expressed as state policy,"' and (ii) the policy is '"actively supervised"' by the State itself." (citations omitted) (quoting Cal. Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc., 445 U.S. 97, 105 (1980))). The court did not consider whether *Hoover* might apply, but this makes sense given that the court had already decided that the restraint under consideration was hybrid. See id. at 223–24 (rejecting argument that MSA and Contraband Statutes are unilateral acts of government). A restraint cannot be the sovereign act of a state if it creates a space for unregulated private power. See supra Part I.C.2 for further discussion of the overlap between the preemption and state action analyses.

179. 357 F.3d at 231 ("Neither the New York statutes, the MSA, nor any other New York law or regulation 'actively supervise[s]' the pricing decisions within the allegedly-anticompetitive market structure enforced by the Contraband Statutes. Appellees' brief does not claim otherwise or even discuss the issue." (quoting *Midcal*, 445 U.S. at 105)).

180. Id. at 232.

protected from antitrust liability. Part II.D.2 considers decisions in the Fifth, Sixth, Eighth, and Tenth Circuits that reached the same conclusion as *Sanders*.

1. *Ninth Circuit:* Sanders v. Brown. — In *Sanders v. Brown*, a class of smokers sued the California Attorney General and the OPMs.[181] The named plaintiff, Sanders, challenged the Qualifying and Contraband Statutes on their face, claiming they were preempted by the Sherman Act.[182] Sanders also alleged specific antitrust injury, pointing to post-MSA parallel price increases as illegal price fixing, and argued that the implementing statutes failed *Midcal*'s active supervision requirement.[183] The district court granted a motion to dismiss, holding that the Sherman Act did not preempt the implementing statutes and, even if it did, the defendants were immune from liability under the state action doctrine.[184]

In affirming the district court, the Ninth Circuit first held that the Sherman Act did not preempt the implementing statutes because the statutes did not contemplate conduct that was a per se violation in all cases.[185] The court noted that the statutes did not explicitly allow price fixing.[186] Sanders, however, did not argue that there was an explicit price-fixing agreement.[187] Instead, he argued that the MSA penalized price competition by forcing tobacco manufacturers to pay more money to the states as their market shares increased.[188] Sanders alleged that this effectively resulted in MSA participants agreeing to compensate each other for market share increases.[189] Thus, when one firm raised its price, other participants allegedly could have raised prices in lockstep without fear of being undercut.[190] Potentially, NPMs could have entered the market and undercut the participating manufacturers (PMs) (which included the

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181. 504 F.3d 903, 906 (9th Cir. 2007).

182. Id. at 909 ("This scheme is preempted by the Sherman Act, Sanders argues, because it so obviously conflicts with federal antitrust law.").

183. Id. ("Sanders argues that even if the scheme consisting of the MSA and its implementing statutes is not facially preempted, the tobacco defendants have still committed illegal price-fixing, as evidenced by the parallel price increases. Finally, Sanders argues that the State of California failed to adequately supervise the tobacco companies' pricing actions.").

184. Sanders v. Lockyer, 365 F. Supp. 2d 1093, 1101, 1104–05 (N.D. Cal. 2005), aff'd sub nom. Sanders v. Brown, 504 F.3d 903.

185. See 504 F.3d at 911 ("Sanders . . . has failed to adequately allege that the implementing statutes mandate or authorize conduct that 'in all cases' violates federal antitrust law. The implementing statutes are thus not preempted by the Sherman Act." (citations omitted) (quoting Fisher v. City of Berkeley, 475 U.S. 260, 265 (1986))).

186. Id.

187. See id. at 909 ("Sanders does not allege that the tobacco companies have agreed amongst themselves to fix prices.").

188. Id. Sanders's argument was similar to that of the plaintiffs in *Freedom Holdings*. See supra notes 173–177 and accompanying text.

189. 504 F.3d at 909.

190. Id.

OPMs and SPMs). But Sanders argued that the Qualifying and Contraband Statutes, by requiring NPMs to join the MSA or make escrow payments, created "high barriers to NPMs' market entry" and took away their "ability to price-compete."[191] In Sanders's view, "[t]he statutes therefore place[d] irresistible pressure on all cigarette companies to fix prices."[192]

The Ninth Circuit admitted that the implementing statutes "may cause higher prices and dissuade some potential market entrants" because NPMs will have to account for escrow payments in setting prices.[193] But the court did not believe that the statutes inevitably resulted in price fixing.[194] It speculated that if the PMs were really charging supracompetitive prices, an NPM could charge a lower price that would still account for the escrow payment.[195] The Ninth Circuit thus concluded that Sanders had failed to show that the implementing statutes mandated or authorized conduct that violated antitrust law "in all cases."[196]

The *Sanders* court's reasoning on the preemption issue is problematic. Nothing in the *Rice* or *Fisher* decisions says that the statute must explicitly authorize or require a per se violation to lose immunity. *Rice* teaches that for a statute to be preempted, it must mandate, authorize, *or* place "irresistible pressure" on a private party to engage in conduct that is "in all cases a *per se* violation."[197] There is substantial support for the proposition that the MSA creates such pressure to engage in per se antitrust violations.[198] And by suggesting that the NPMs could undercut the PMs on price, the court seemed to ignore the intent behind the MSA.

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191. Id. at 911.

192. Id.

193. Id.

194. See id. ("Nothing, however, forces the NPMs to either peg their prices to those of participating manufacturers, or to refrain altogether from entering the market.").

195. See id. ("If the OPMs really are charging artificially high prices, and thus making artificially high profits, an NPM conceivably could compete on price by charging a 'normal' price and still make a 'normal' profit, even taking the escrow payment into account.").

196. See id. ("Sanders therefore has failed to adequately allege that the implementing statutes mandate or authorize conduct that 'in all cases' violates federal antitrust law.").

197. Rice v. Norman Williams Co., 458 U.S. 654, 661 (1982).

198. See 1 Areeda & Hovenkamp, supra note 35, ¶ 217b4, at 366 ("The statute [in *Freedom Holdings*] effectively made it very costly for the participating cigarette manufacturers to increase their market share, thus creating what amounted to a hybrid agreement setting market share."); see also Bulow, supra note 139, at 739 ("[T]he payments are still probably illegal for antitrust reasons. . . . After each settlement the marginal costs of every firm would rise by the same amount, leading immediately to a similar increase in prices and causing consumers to have to pay off the firms' liabilities."); infra notes 222–229 and accompanying text (discussing *Rice*'s "irresistible pressure" language).

The Qualifying Statutes were designed to eliminate cost advantages NPMs might have over PMs.[199]

Though the *Sanders* court held that the Sherman Act did not preempt the implementing statutes, it still had to deal with Sanders's claim that the MSA and implementing statutes had caused actual antitrust injury through a price-fixing cartel.[200] The court dismissed this claim using the state action doctrine. Because the court found that the MSA was a sovereign act of the state, the court followed *Hoover* and held—independent of the *Midcal* test—that the state action doctrine immunized the MSA. In effect, the court deemed the MSA a sovereign state act that therefore deserved *Hoover* immunity.[201] The court provided no support for the proposition that Sanders's injury resulted from a sovereign act of the state. The court acknowledged its split with the Second and Third Circuits and explained that while those circuits applied the *Midcal* test, it declined to do so after deeming the MSA a sovereign act.[202]

The Ninth Circuit's reasoning in *Sanders* on the state action issue is consistent with the district court's reasoning.[203] Areeda and Hovenkamp criticized the district court's apparent belief "that all of the 'conduct' being challenged was that of the state legislature in passing the statute, not the conduct of private firms acting under the statute; under that reasoning, every state statute would qualify for antitrust immunity."[204]

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199. The model statute included in the MSA indicates the desire to eliminate a cost advantage for NPMs:

> It would be contrary to the policy of the State if tobacco product manufacturers who determine not to enter into such a settlement *could use a resulting cost advantage to derive large, short-term profits* in the years before liability may arise without ensuring that the State will have an eventual source of recovery from them if they are proven to have acted culpably. It is thus in the interest of the State to require that such manufacturers establish a reserve fund to guarantee a source of compensation and *to prevent such manufacturers from deriving large, short-term profits* and then becoming judgment-proof before liability may arise.

MSA, supra note 116, exhibit T, at T-1 to T-2 (emphasis added).

200. See *Sanders*, 504 F.3d at 911–12 (noting Sanders's allegations that even if Sherman Act did not preempt implementing statutes, cigarette manufacturers violated Act anyway by establishing price-fixing cartel and that California fostered the cartel by passing the implementing statutes).

201. Id. at 918 (holding "*Parker* immunity protects the state from antitrust liability for entering into the MSA and for passing the implementing statutes" since "the California attorney general's act of entering into the MSA is a sovereign act, as are the legislature's actions in enacting the Qualifying Act and Contraband Amendment").

202. See id. ("The Second Circuit in *Freedom Holdings* and the Third Circuit in [*A.D.*] *Bedell* applied the *Midcal* analysis . . . . [W]e believe the *Midcal* analysis would only be appropriate if the MSA is not a sovereign act, which we conclude it is.").

203. See Sanders v. Lockyer, 365 F. Supp. 2d 1093, 1099 (N.D. Cal. 2005) ("The California legislature enacted the Qualifying Act in 1999 and the Contraband Amendment in 2003. *Parker* makes clear that legislative enactments are direct state action, and under *Hoover*, the *Midcal* analysis is neither appropriate nor required for direct acts of the sovereign."), aff'd sub nom. Sanders v. Brown, 504 F.3d 903.

204. 1A Areeda & Hovenkamp, supra note 35, ¶ 226, at 164 n.1.

To buttress its conclusion, the Ninth Circuit then attacked the *A.D. Bedell* court's holding that the MSA is a "hybrid" restraint and therefore should be judged by the *Midcal* two-pronged test. The Ninth Circuit noted that a "hybrid" restraint requires a delegation of market power to private parties that is per se illegal.[205] It then emphasized its finding that the MSA did not delegate per se illegal power[206] because the MSA did not give its participants the power to fix prices; NPMs could still charge lower prices.[207]

2. *Fifth, Sixth, Eighth, and Tenth Circuits: Agreement with the* Sanders v. Brown *Outcome.* — Other circuits, agreeing with the outcome in *Sanders*, have held that the MSA and implementing statutes are not preempted by the Sherman Act. The Fifth,[208] Sixth,[209] Eighth,[210] and Tenth[211] Circuits

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205. 504 F.3d at 918–19.

206. Id.

207. See supra notes 193–196 and accompanying text (describing Ninth Circuit's analysis finding MSA and implementing statutes did not constitute per se antitrust violation).

208. In *S&M Brands, Inc. v. Caldwell*, the Fifth Circuit rejected the argument that the MSA and implementing statutes constitute a per se violation because they disincentivize the NPMs from engaging in price competition with the PMs:

> "The genesis of this anticompetitive behavior, however, stemmed neither from the MSA nor the complementary legislation that Kentucky enacted to give effect to the MSA's provisions. Instead, the behavior with which Trident *really* takes issue is the behavior of the PMs following the MSA's enactment. Because such behavior was neither mandated nor explicitly authorized by the state, [it cannot be preempted by the Sherman Act]."

614 F.3d 172, 177 (5th Cir. 2010) (quoting Trident Int'l Corp. v. Kentucky, 467 F.3d 547, 557 (6th Cir. 2006)), cert. denied, 131 S. Ct. 1601 (2011).

209. See *Trident*, 467 F.3d at 557 (finding no preemption under *Rice* because anticompetitive behavior at issue resulted from behavior of PMs after MSA implementation and was not mandated or authorized by MSA and statutes themselves); see also S&M Brands, Inc. v. Summers, 393 F. Supp. 2d 604, 629–30 (M.D. Tenn. 2005) (following *Sanders* and finding that MSA and implementing statutes do not constitute either per se violation in all cases or hybrid restraint because they do not "authorize collusive action among the participating tobacco manufacturers, nor do they give tobacco manufacturers regulatory authority to set prices in the cigarette market"), aff'd, 228 F. App'x 560 (6th Cir. 2007).

210. In *Grand River Enterprises Six Nations v. Beebe*, the court found no per se violation, noting that while "the statute in question place[d] some pressure on NPMs to charge higher prices to offset the escrow payments, this pressure [did] not force NPMs to raise prices 'in all cases.'" 574 F.3d 929, 937 (8th Cir. 2009) (quoting Rice v. Norman Williams Co., 458 U.S. 654, 661 (1982)). The Eighth Circuit criticized the Third Circuit's *A.D. Bedell* decision: "We disagree with the Third Circuit's conclusion that powerful disincentives are sufficient to constitute an antitrust violation under controlling Supreme Court precedent. Powerful disincentives may not produce the 'irresistible pressure' which is required for an antitrust violation." Id. at 938 (quoting *Rice*, 458 U.S. at 661).

211. In *KT&G Corp. v. Attorney General of Oklahoma*, the court found no per se violation:

> [The MSA] only requires NPMs to make an annual escrow payment . . . . The fact that the amount of that escrow payment is capped by referencing the amount that the NPM would have paid under the MSA on that same volume of

have held that the MSA and implementing statutes neither mandate a per se violation of the antitrust laws, nor constitute a hybrid restraint.

Further, the Eighth Circuit followed *Sanders v. Brown* in holding that *Parker* state action immunity protects the MSA. Like the Ninth Circuit in *Sanders* and the Third Circuit in *A.D. Bedell*, the Eighth Circuit in *Grand River Enterprises Six Nations v. Beebe* confronted the choice between applying *Hoover* (and thus finding automatic state action immunity) or applying *Midcal* (and thus applying the clear articulation and active state supervision tests).[212] The *Grand River* court applied *Hoover*, reasoning that the state of Arkansas entered into the MSA and legislatively enacted the implementing statutes.[213] Thus, without resorting to *Midcal*'s two-pronged test, the court held that state action immunity applied.[214]

In summary, the Second Circuit held that the MSA's implementing statutes were preempted by federal antitrust law because they caused a per se antitrust violation and constituted a hybrid restraint that grants cigarette manufacturers an unsupervised degree of private regulatory power.[215] In contrast, the Fifth, Sixth, Eighth, Ninth, and Tenth Circuits all held that the MSA and implementing statutes neither mandated a per se violation of the antitrust laws nor constituted a hybrid restraint.[216] Regarding state action, the Second and Third Circuits held that *Midcal*'s two-pronged test should apply to the MSA and that the MSA fails *Midcal*'s active supervision requirement.[217] Again, in contrast, the Eighth and Ninth Circuits held that *Hoover*, rather than *Midcal*, should apply to the MSA, and that the MSA is a sovereign state act that is automatically im-

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> sales does not change the fact that the statute, on its face, does not mandate or authorize conduct that is a per se violation of the Sherman Act in all cases.

535 F.3d 1114, 1130 (10th Cir. 2008). The court also found that the MSA did not constitute a hybrid restraint, because the "connection . . . [between the antitrust injury and] the conduct of private entities is too attenuated for this court to conclude that Kansas and Oklahoma have delegated regulatory power to these private individuals." Id. at 1131.

212. *Grand River*, 574 F.3d at 941 (discussing choice between *Midcal* and *Hoover*.)

213. Id. ("Although we have never had occasion to follow *Hoover*, it appears to be apposite to the instant facts. The State of Arkansas entered into the MSA and legislatively enacted the Allocable Share Amendment.").

214. Id.

215. See supra notes 169–177 and accompanying text (describing Second Circuit's preemption analysis in *Freedom Holdings*).

216. See supra notes 193–196 and accompanying text (describing Ninth Circuit's preemption analysis in *Sanders*); supra notes 208–211 (citing decisions in Fifth, Sixth, Eighth, and Tenth Circuits finding no antitrust preemption).

217. See supra notes 153–161 and accompanying text (describing Third Circuit's reasoning on *Midcal* applicability); supra notes 162–163 and accompanying text (describing Third Circuit's reasoning on active supervision); supra note 178 and accompanying text (describing Second Circuit's reasoning on *Midcal* applicability); supra notes 179–180 (describing Second Circuit's reasoning on active supervision).

mune from federal antitrust law.[218] Part III reviews the sources of this circuit split and evaluates the merits of each approach.

III. EVALUATING THE CIRCUIT SPLIT: COURTS SHOULD REVIVE *RICE*'S "IRRESISTIBLE PRESSURE" LANGUAGE AND DISTINGUISH PRIVATE ACTORS FROM PUBLIC ACTORS

This Part analyzes the differences in reasoning among those circuits that have assessed the antitrust liability of the MSA. Part III.A finds that the split regarding preemption is driven by differing interpretations of the Supreme Court's decision in *Rice*, specifically its "irresistible pressure" language. This Part recommends that courts considering antitrust preemption give greater consideration to whether a state statute creates "irresistible pressure" to commit per se violations of the antitrust laws, not just whether it explicitly mandates a per se violation. This approach is more consistent with Supreme Court doctrine and has been adopted in non-MSA preemption cases.

Part III.B finds that the split regarding state action is driven by different conclusions regarding the source of antitrust injury. The Eighth and Ninth Circuits applied state action immunity because they attributed the alleged antitrust injury to the sovereign acts of the states and therefore applied *Hoover*; the Second and Third Circuits declined to apply state action immunity because they attributed the alleged antitrust injury to the acts of private cigarette manufacturers—as a result, these circuits applied the *Midcal* test. This Part praises the analysis undertaken by the Second and Third Circuits and recommends that courts weighing the applicability of *Hoover* and *Midcal* take greater care to identify the source of antitrust injury. There may be good policy reasons, related to the public health problems caused by smoking, to protect the MSA from liability,[219] but if courts are determined to immunize the MSA, they should go about it in a way that does the least violence to antitrust immunity doctrine.

A. *Antitrust Preemption*

The Second Circuit found that the MSA and implementing statutes would constitute per se violations of the Sherman Act if implemented by private parties.[220] Therefore, the MSA and implementing statutes are

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218. See supra notes 200–206 and accompanying text (describing Ninth Circuit's state action analysis in *Sanders*); supra notes 212–214 and accompanying text (describing Eighth Circuit's state action analysis in *Grand River*).

219. See infra notes 265–266 and accompanying text (discussing reluctance of many courts to challenge MSA for public policy reasons).

220. Freedom Holdings, Inc. v. Spitzer, 357 F.3d 205, 226 (2d Cir. 2004) ("The alleged arrangement, even without the protection of the Contraband Statutes as enforced by wholesalers, would be a *per se* violation because it is a naked restraint on competition, al-

preempted. Other circuits, however, found that the MSA and implementing statutes do not contemplate conduct that is always a per se violation of the Sherman Act and therefore cannot be preempted.[221]

The divergence appears to be driven by differing interpretations of the Supreme Court's decision in *Rice*. That decision held that a statute may be preempted by the Sherman Act "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 in order to comply with the statute."[222] Circuits disagree on the relevance and meaning of "irresistible pressure" in that statement. The Second Circuit found that the MSA's structure created "irresistible pressure" on cigarette manufacturers to violate the antitrust laws by creating "powerful disincentives" to compete on price.[223] By contrast, the Fifth, Sixth, Eighth, Ninth, and Tenth Circuits focused on whether the MSA *required or explicitly authorized* a violation of the antitrust laws.[224] These latter courts, for the most part, appear to ignore the phrase "irresistible pressure."[225] And because the MSA does not *require* cigarette manufactur-

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beit one subject to erosion by NPMs. . . . We therefore hold that appellants have sufficiently alleged a per se violation of the Sherman Act.").

221. See, e.g., Grand River Enters. Six Nations v. Beebe, 574 F.3d 929, 937 (8th Cir. 2009) ("Although the statute in question places some pressure on NPMs to charge higher prices to offset the escrow payments, this pressure does not force NPMs to raise prices 'in all cases.'" (citation omitted)); Sanders v. Brown, 504 F.3d 903, 911 (9th Cir. 2007) ("Nothing, however, forces the NPMs to either peg their prices to those of participating manufacturers, or to refrain altogether from entering the market. . . . Sanders therefore has failed to adequately allege that the implementing statutes mandate or authorize conduct that 'in all cases' violates federal antitrust law." (citation omitted)).

222. Rice v. Norman Williams Co., 458 U.S. 654, 661 (1982) (emphasis added).

223. See *Freedom Holdings*, 357 F.3d at 226 ("[T]he combination of the MSA, the Escrow Statutes, and the Contraband Statutes, allows OPMs to set supracompetitive prices that effectively cause other manufacturers either to charge similar prices or to cease selling. NPMs are forced to charge these prices to cover the costs imposed by the Escrow and Contraband Statutes or go out of business in New York." (citation omitted)); see also A.D. Bedell Wholesale Co. v. Philip Morris Inc., 263 F.3d 239, 248 (3d Cir. 2001) ("Plaintiffs allege the agreement between the States and the Majors purposefully creates powerful disincentives to increase cigarette production. . . . [T]he penalty of higher settlement payments for increased market share would discourage reducing prices here. For this reason, signatories have an incentive to raise prices to match increases by competitors.").

224. See supra notes 208–211.

225. See Robert W. Bauer, Note, *Sanders v. Brown*: State-Action Immunity and Judicial Protection of the Master Settlement Agreement, 34 J. Corp. L. 1291, 1302 (2009) ("Despite the 'irresistible pressure' phrase in the *Rice* opinion, courts evaluating antitrust challenges in the MSA realm routinely, albeit inexplicably, ignore that phrase in their conclusions."). The Eighth Circuit in *Grand River* raised the issue, but only to attack the Third Circuit's holding in *A.D. Bedell*, arguing that "[p]owerful disincentives may not produce the 'irresistible pressure' which is required for an antitrust violation." 574 F.3d at 938. The court cited *Rice*, 458 U.S. at 661, to support this argument, without citing any other cases or authorities. 574 F.3d at 938. But *Rice* does not say anywhere that powerful incentives are insufficient to constitute "irresistible pressure." In fact, the *Rice* decision does not give any content to the phrase "irresistible pressure."

ers to charge supracompetitive prices or divide markets, it was easy for these courts to find that there was no per se violation sufficient to result in preemption.

There is almost no judicial or academic interpretation of *Rice*'s "irresistible pressure" language. It is, however, part of controlling Supreme Court precedent and should not be ignored. The structure of the language—"if it mandates or authorizes conduct . . . or if it places irresistible pressure"[226]—suggests that "irresistible pressure" is something distinct from "mandates or authorizes."[227] And while courts have not given content to "irresistible pressure," it is "difficult to fathom a greater pressure on a business than the desire to remain profitable."[228] And a review of the relevant economic and antitrust literature indicates that the MSA creates pressure on firms to charge supracompetitive prices.[229] Thus, the Second Circuit's analysis—which concluded that the MSA and implementing statutes are preempted by the Sherman Act—is more persuasive.

Other courts considering antitrust preemption claims have held that a state statute may be preempted, even if the statute at issue does not explicitly authorize or mandate horizontal price fixing. In *Costco Wholesale Corp. v. Maleng*, the Ninth Circuit considered whether the Sherman Act preempted a Washington law that required wholesalers of beer and wine to post their prices and adhere to them for thirty days.[230] The court held that this "post-and-hold" law constituted a hybrid restraint because the state had no control over price levels; they were left exclusively to the wholesaler.[231] More to the point, the court found that the post-and-hold law constituted a per se restraint.[232] It justified this result by explaining that "agreements to adhere to posted prices are anticompetitive because they are *highly likely* to facilitate horizontal collusion among market participants."[233] The court noted that the post-and-hold statute may "'facilitate tacit collusion'" though it "'d[id] not explicitly authorize any kind of

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226. *Rice*, 458 U.S. at 661.

227. See Bauer, supra note 225, at 1302 ("While the [*Sanders*] court's focus on the phrase 'mandate or authorize' was not necessarily inappropriate or erroneous, the 'or' language of the precedent strongly suggests that the language of the precedent is disjunctive, and the 'irresistible pressure' phrase would also be sufficient to find conduct in violation of the Sherman Act.").

228. Id. at 1303; see also id. ("Although the 'irresistible pressure' language may be somewhat amorphous, a fair reading of the text compels the conclusion that the implementing statutes place irresistible pressure on all tobacco manufacturers—participating and non-participating—to engage in anticompetitive behavior.").

229. See supra Part II.B (discussing economic effects of MSA).

230. 522 F.3d 874, 892 (9th Cir. 2008).

231. See id. at 894 (finding hybrid restraint where state "has only part of the power of the Rent Stabilization Board [in *Fisher*]; it may police the *procedures* of posting and the adherence to the posted prices, but it retains no control over the prices themselves").

232. Id. at 895.

233. Id. at 896 (emphasis added).

collusion.'"[234] In *Costco*, the Ninth Circuit found that it is not necessary for a statute to explicitly authorize or require a per se violation to be preempted; it is enough to show that collusion is highly likely. The Ninth Circuit thus contradicted its own position in *Sanders*, where it held that a statute must require a per se violation to be preempted.[235]

Allowing antitrust preemption even when the statute at issue does not explicitly mandate or require anticompetitive activity does not just align with Supreme Court precedent; it also makes good policy sense. The antitrust preemption and state action doctrines are intended to prevent the states from displacing federal antitrust law and substituting the unsupervised discretion of private market participants. States should have to substitute their own supervision in place of federal antitrust law.[236] This policy is furthered by allowing courts to investigate whether a state statute gives private parties the unsupervised ability to engage in a per se antitrust violation, regardless of whether the statute mandates or explicitly authorizes such a violation. Otherwise, antitrust preemption doctrine creates a loophole; states could facilitate and incentivize price-fixing schemes by private parties, without being forced to supervise those schemes. The state would only have to make sure that the statute did not explicitly require a price-fixing scheme.

B. *State Action*

In *A.D. Bedell*, the Third Circuit weighed applying *Hoover* (and automatic state action immunity) against applying *Midcal* (and its state action immunity requirements of clear articulation and active state supervision). It applied *Midcal* because it found that the cigarette manufacturers' conduct after MSA implementation, rather than the acts of the state government, were the "direct source of the anticompetitive injuries" alleged by plaintiffs.[237] It also found the MSA was deserving of *Midcal* treatment because the MSA is a hybrid restraint.[238]

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234. Id. at 895 (quoting Lopatka & Page, supra note 2, at 312).

235. See supra notes 193–196, 205–207 and accompanying text (describing *Sanders* court's holding that implementing statutes did not require per se violation in all cases and therefore were not preempted). The *Costco* court did not address *Sanders*'s reasoning on this issue.

236. See 1A Areeda & Hovenkamp, supra note 35, ¶ 226, at 164 ("[T]he state does not have the power simply to displace the federal antitrust laws and then abandon the market at issue to the unsupervised discretion of private participants."); see also Mass. Food Ass'n v. Mass. Alcoholic Beverages Control Comm'n, 197 F.3d 560, 565 (1st Cir. 1999) ("What is centrally forbidden is state licensing of arrangements between private parties that suppress competition . . . .").

237. A.D. Bedell Wholesale Co. v. Philip Morris Inc., 263 F.3d 239, 258 (3d Cir. 2001).

238. Id. ("[T]his case resembles a 'hybrid restraint' . . . . [H]ybrid restraints involve a degree of private action which calls for *Midcal* analysis." (citing Rice v. Norman Williams Co., 458 U.S. 654, 666–67 (1982) (Stevens, J., concurring))).

In *Sanders*, the Ninth Circuit reached the opposite conclusion and applied *Hoover*. It asserted that the MSA was a sovereign act of the state and thus entitled to automatic immunity.[239] The *Sanders* court also rejected *A.D. Bedell*'s finding that the MSA was a hybrid restraint, because the *Sanders* court found in its preemption analysis that the MSA did not involve the delegation of per se illegal power.[240] Finally, the Ninth Circuit found that the alleged injury was properly attributed to the state, and so applied *Hoover*.[241]

The Third Circuit's analysis in *A.D. Bedell* is more persuasive on the issue of state action immunity.[242] The *Sanders* court reasoned that the challenged conduct was entirely the result of the state legislature passing a statute. As Areeda and Hovenkamp note, this reasoning is flawed: It would result in every state statute qualifying for antitrust immunity.[243] Indeed, the statute being challenged in *Midcal* was passed by the California state legislature, but it did not automatically qualify for immunity.[244]

What really matters in state action analysis is whether the statute gives private parties unsupervised discretion to violate the federal antitrust laws. Such a delegation of unsupervised power to private parties is impermissible.[245] That unsupervised delegation is what the statute in *Midcal* allowed and what the MSA also allegedly allows. The *Midcal* Court warned against states shielding unsupervised private agreements when it declared that "[t]he national policy in favor of competition cannot be thwarted by casting such a gauzy cloak of state involvement over what is essentially a private price-fixing arrangement."[246] Thus, courts must be

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239. Sanders v. Brown, 504 F.3d 903, 918 (9th Cir. 2007) (holding California attorney general's act of entering into MSA was sovereign act and therefore "*Parker* immunity protect[ed] the state from antitrust liability for entering into the MSA and for passing the implementing statutes"); see also supra notes 213–214 and accompanying text (describing Eighth Circuit following similar logic in *Grand River*).

240. 504 F.3d at 918–19 ("[A hybrid] scheme necessarily involves a delegation of market power to private parties that is *per se* illegal under the Sherman Act. . . . [T]he MSA involves no such delegation of *per se* illegal power such as the ability to fix prices."); see also Costco Wholesale Corp. v. Maleng, 522 F.3d 874, 877 (9th Cir. 2008) ("[O]nce we determine that a restraint is unilaterally imposed by the state as sovereign, *Parker* immunity applies without further inquiry.").

241. See 504 F.3d at 918 ("[W]e believe the *Midcal* analysis would only be appropriate if the MSA is not a sovereign act, which we conclude it is.").

242. See supra notes 200–207 and accompanying text (criticizing *Sanders* court's state action analysis).

243. 1A Areeda & Hovenkamp, supra note 35, ¶ 226 n.1, at 164.

244. See Cal. Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc., 445 U.S. 97, 99 (1980) (describing wine pricing statute at issue); id. at 105 (applying "clear[] articulat[ion]" and "active[] supervis[ion]" tests and finding no active state supervision (quoting City of Lafayette v. La. Power & Light Co., 435 U.S. 389, 410 (1978) (plurality opinion))).

245. 1A Areeda & Hovenkamp, supra note 35, ¶ 226, at 164.

246. 445 U.S. at 106.

more careful in evaluating whether an antitrust injury results from the state's unilateral conduct or unsupervised private actions.

The problem of distinguishing private and public actors for state action purposes is not a new one.[247] Areeda and Hovenkamp propose that an entity should be characterized as private if a "decisive coalition (usually a majority) is made up of participants in the regulated market."[248] Elhauge similarly argues "an anticompetitive restraint is immune from antitrust liability whenever a financially disinterested and politically accountable actor controls and makes a substantive decision in favor of the terms of the restraint."[249] And the "strongest criterion for identifying the relevant actor should be the discretion to make the challenged decision."[250] In the *Hoover* context, that would have meant that the bar committee, rather than the state supreme court, was the relevant actor for antitrust purposes, because the committee had the discretion to exclude people from practicing law.[251] In the MSA context, this would suggest that the relevant actors were the cigarette manufacturers; they had the discretion to raise prices to supracompetitive levels that other manufacturers could match. And the cigarette manufacturers were certainly not financially disinterested regarding price and output decisions.

Agencies and courts do sometimes engage in thorough and fact-sensitive analyses to determine the relevant actors when evaluating claims of state action immunity. For example, the FTC considered whether state action immunity applied to the North Carolina Board of Dental Examiners' conduct excluding nondentists from the teeth whitening services market.[252] The Board argued that the conduct automatically received state action immunity because the Board was an instrumentality of the state of North Carolina.[253] The government argued that the Board should have to satisfy both prongs of the *Midcal* test because the board was made up of dentists who were financially interested in excluding

247. See 1A Areeda & Hovenkamp, supra note 35, ¶ 227a, at 198 ("Distinguishing private actor from public actors and actions has proved to be a vexatious question in antitrust litigation, as illustrated by its various doctrinal manifestations.").

248. Id. ¶ 227b, at 209.

249. Einer Richard Elhauge, The Scope of Antitrust Process, 104 Harv. L. Rev. 667, 696 (1991).

250. 1A Areeda & Hovenkamp, supra note 35, ¶ 227b, at 209.

251. Id. ("To the extent that the state supreme court was not involved in making the exam, grading it, or determining who would pass, the inference seems strong that the relevant actor was the Committee rather than the Court."); see also id. ¶ 227, at 208 ("Without reasonable assurance that the body is far more broadly based than the very persons who are to be regulated, outside supervision seems required.").

252. N.C. Bd. of Dental Exam'rs, 151 F.T.C. 607 (2011).

253. Id. at 617 ("[T]he Board argues that its challenged conduct is exempt from the federal antitrust laws because, as an instrumentality of the State of North Carolina, its actions are protected by the state action doctrine.").

nondentists from the market.[254] The FTC sided with the government and ruled that the Board's decision to exclude nondentists from the teeth whitening business was subject to the *Midcal* two-pronged test.[255] The FTC reviewed the structure and makeup of the Board[256] and concluded that "we lack assurance that the Board's efforts to exclude non-dentists from providing teeth whitening services in North Carolina represent a sovereign policy choice to supplant competition rather than an effort to benefit the dental profession."[257] The FTC's skeptical, fact-sensitive analysis offers a useful template for courts to use in distinguishing public and private actors for state action purposes.[258]

To summarize, the circuits are split as to whether federal antitrust law preempts the MSA. This split results from disagreement as to whether a statute must *mandate* a per se antitrust violation to be preempted. The Fifth, Sixth, Eighth, Ninth and Tenth Circuits reasoned that preemption requires such a mandate and therefore held that the MSA is not preempted because it does not explicitly require cigarette manufacturers to engage in price fixing.[259] Conversely, the Second Circuit found it sufficient that the MSA created powerful incentives to fix prices and, therefore, violated the antitrust laws.[260] The Second Circuit's approach is more consistent with the Supreme Court's holding in *Rice*, which states that a statute may be preempted if "it places irresistible pressure on a private party to violate the antitrust laws in order to comply with the statute."[261] *Rice* suggests that a statutory scheme creating powerful incentives to violate antitrust laws is enough to be preempted by the Sherman Act. This

254. Id. at 618 ("Complaint Counsel argues that the Board is financially interested in the exclusion of non-dentists from the market for teeth whitening services . . . . Therefore, says Complaint Counsel, the Board must meet both of *Midcal*'s prongs in order to qualify for state action exemption.").

255. Id. at 626 ("We accordingly hold that a state regulatory body that is controlled by participants in the very industry it purports to regulate must satisfy both prongs of *Midcal* to be exempted from antitrust scrutiny under the state action doctrine.").

256. Id. at 612–13 (finding Board was made up of practicing dentists and hygienists who offered dental services, including teeth whitening, and competed with nondentists offering teeth whitening).

257. Id at 626.

258. For examples of courts engaging in similar analysis on the public versus private actor issue, see Wash. State Elec. Contractors Ass'n, Inc. v. Forest, 930 F.2d 736, 737 (9th Cir. 1991) (holding whether active supervision is required depends on the nature of entity, such as having private members who "have their own agenda which may or may not be responsive to state . . . policy"); FTC v. Monahan, 832 F.2d 688, 689–90 (1st Cir. 1987) ("Whether any 'anticompetitive' Board activities are 'essentially' those of private parties"—and hence subject to active supervision—"depends upon how the Board functions in practice, and perhaps upon the role played by its members who are private pharmacists.").

259. See supra notes 224–225 and accompanying text (describing rationale of these circuits).

260. See supra note 223 and accompanying text (describing Second Circuit's reasoning in *Freedom Holdings*).

261. Rice v. Norman Williams Co., 458 U.S. 654, 661 (1982).

conclusion is supported by preemption cases outside the MSA context and makes good policy sense considering antitrust preemption's goal of preventing states from creating unsupervised spheres of private regulatory power.

The circuits are also split as to whether state action immunity protects the MSA. The split is explained by conflict over whether the MSA should be judged by *Hoover* (leading to automatic state action immunity) or by *Midcal* (requiring a showing of clear articulation and active state supervision). The Eighth and Ninth Circuits found that *Hoover* applied to the MSA, perceiving it as a sovereign state action, and therefore found it automatically immune under the state action doctrine.[262] The Second and Third Circuits found instead that *Midcal* applied to the MSA because the anticompetitive conduct at issue was undertaken by private cigarette manufacturers, rather than the state.[263] The Second and Third Circuits then found that the MSA failed *Midcal*'s active supervision requirement and therefore held the MSA was not immune from antitrust challenge under the state action doctrine.[264] The Second and Third Circuits were correct to find that *Midcal* applied to the MSA. The Supreme Court's holding in *Midcal* requires courts to be vigilant against state grants of private, unchecked regulatory power. Courts must take greater care to identify the source of antitrust injury and to apply *Midcal* when private actors are the source of that injury.

CONCLUSION

Understandably, courts are reluctant to find the MSA susceptible to antitrust liability and to undo the work of the states in settling their claims against cigarette manufacturers.[265] This reluctance may help explain the decisions of federal courts finding that antitrust preemption

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262. See supra notes 213–214, 239–240 and accompanying text (describing Eighth and Ninth Circuit state action analyses).

263. See supra notes 237–238 and accompanying text (describing Third Circuit's state action analysis).

264. See supra notes 162–163, 178–179 and accompanying text (describing Second and Third Circuit's active supervision analyses).

265. Margaret A. Little describes the dilemma facing courts in this area:

> The central problem is: What judge—state or federal—wants to invalidate a settlement agreement signed by fifty attorneys general, apparently entered as a court order in some states, endorsed by at least forty state legislatures that have enacted some form of the Qualifying Statute, and thereby reduce his state's treasury by billions—and, incidentally, by so doing throw his court's doors and other states' court doors open to resumed litigation, the breadth of which is and was utterly unprecedented in American history?

Margaret A. Little, A Most Dangerous Indiscretion: The Legal, Economic, and Political Legacy of the Governments' Tobacco Litigation, 33 Conn. L. Rev. 1143, 1178 (2001) (citation omitted).

and state action immunity protect the MSA from antitrust scrutiny.[266] Nevertheless, the courts evaluating the MSA have erred in finding it immune from antitrust liability. They have ignored the Supreme Court's instruction in *Rice* that a statute that creates "irresistible pressure" to violate the antitrust laws may be preempted; instead, courts have taken an unnecessarily restrictive view and have looked for the statute to explicitly authorize or require an antitrust violation. As a result, these courts protect conduct that should receive antitrust scrutiny according to Supreme Court precedent. Courts should give greater deference to the Supreme Court's instruction that pressure or incentives are sufficient to find a per se violation. Further, these courts have erred in finding that the antitrust injury caused by the MSA is the result of sovereign state action and therefore automatically immune under *Hoover*. The antitrust injuries caused by the MSA—supracompetitive prices and market division—are more properly viewed as the unsupervised acts of private cigarette manufacturers. In conducting state action analysis, courts should be more careful in analyzing whether an actor is properly characterized as public or private. Courts understandably do not want to disturb the MSA. But in their efforts to protect it, they are shielding anticompetitive conduct from antitrust scrutiny and marring the preemption and state action doctrines.

266. See Bauer, supra note 225, at 1292 (criticizing *Sanders* decision as flawed and arguing it can be explained only by "ends-driven judicial logic"); see also 1 Areeda & Hovenkamp, supra note 35, ¶ 217b4, at 367 (arguing while reduced smoking that may come from higher prices is "important policy concern . . . it is not one that is properly effected through the device of an unsupervised cartel agreement").

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