Memorandum

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To: Bob O'Grady

From: David H. Evans
Lauren Tabak

Re: State Action Immunity and Lee Memorial Health System

Lee Memorial Health System, a not-for-profit, community-owned hospital system in Southwest Florida ("Lee Memorial") recently announced the acquisition of two neighboring hospitals. Following the acquisition, Lee Memorial will own five out of the six hospitals in Lee County and will control almost 100% of the market. Lee Memorial's purchase of the hospitals may violate certain federal and state antitrust laws that prohibit anticompetitive acquisitions. In 1994, in a case involving a similar acquisition by Lee Memorial, the United States Court of Appeals for the 11th Circuit found that Lee Memorial is entitled to antitrust immunity under the State Action doctrine and could proceed with the acquisition. You wish to know whether Lee Memorial's acquisition of those hospitals is similarly immune under that decision, or if circumstances have changed.

Standard

The doctrine of state action immunity protects subdivisions of a state government from antitrust liability when there is a clearly expressed state policy authorizing anticompetitive acts. For an entity to be entitled to state action immunity, it must prove that: (1) it is a political subdivision of the state; and (2) that the state authorizes the political subdivision to perform the action in question; and (3) that the state has clearly articulated a state policy authorizing anticompetitive conduct. See FTC v. Hospital Board of Directors of Lee County, 38 F.3d 1184, 1187-88 (11th Cir. 1994).

Brief Answer

Little has changed in Eleventh Circuit case law since the 1994 Lee County decision regarding the test for state action immunity. The courts have applied the Lee County test set forth above and have defined foreseeability as whether the outcome could be reasonably anticipate~~d a~~s in the Lee County decision. Therefore, it is highly unlikely that a case today, based on the facts provided, would be decided any differently.

Parker *and Its Progeny*

- Parker v. Brown, 317 U.S. 341 (1943). In Parker v. Brown, 317 U.S. 341 (1943), the U.S. Supreme Court first determined that state action existed in antitrust law. The California legislature had enacted a law that restricted the marketing of privately produced raisins in an effort to restrict competition and stabilize prices. Parker held that the Sherman Act was not to infringe upon a state's sovereign right to regulate markets within its borders.

- California Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc., 445 U.S. 97 (1980). Forty years later, the Supreme Court established the Midcal test for state action immunity. The Midcal test has two prongs: (1) the challenged policy must be "clearly articulated and affirmatively expressed as state policy," including sanctioning anticompetitive conduct; and (2) the state must provide for "active supervision" of actions taken pursuant to such policy. Id.

- Town of Hallie v. City of Eau Claire, 471 U.S. 34 (1985). In Hallie, several unincorporated townships argued that the City of Eau Claire had violated the Sherman Act by monopolizing the provision of area sewage treatment services and by tying the provision of such services to sewage collection and transportation services. Wisconsin statutes granted city governments the authority for construction activities relating to sewage systems and ordinances for a city operating a public utility to limit the provision of such service in unincorporated areas. The Supreme Court held that the statutes contemplated that a city could engage in anticompetitive conduct in the provision of sewage services. The Court also said that such anticompetitive conduct was "a foreseeable result of empowering the City [of Eau Claire] to refuse to serve unannexed areas." Id. at 42.

  The Hallie decision made two significant changes to the doctrine of state action immunity. First, it eliminated the active supervision requirement for political subdivisions of the state. The Court stated that the active supervision requirement was mostly evidentiary and only necessary when private actors were at issue. Second, the Court added a foreseeability standard. The entity under attack must demonstrate that the anticompetitive activities were a foreseeable result of the policy authorized by the State. Id. at 41.

- F.T.C. v. Hospital Bd. of Directors of Lee County, 38 F.3d 1184 (11th Cir. 1994). In 1994, the Federal Trade Commission ("FTC") brought suit under Section 7 of the Clayton Act to prevent Lee Memorial's Board of Directors from acquiring Cape Coral Hospital – a private non-profit hospital. The acquisition would have, and succeeded, in increasing Lee Memorial's share of the Lee County market from 49% to approximately 67%. The parties agreed that Lee Memorial was a political subdivision of the State of Florida and was not subject to the active supervision requirement. The issue was whether the authorizing legislation constituted a clear articulation and express affirmation of state policy under Hallie's foreseeability standard. Lee County, 38 F.3d at 1188.

The Eleventh Circuit examined the history of Lee Memorial and the legislation enacted by the Florida legislature. The legislation allowed Lee Memorial to acquire neighboring hospitals, sue and be sued, enter into contracts and to participate in or control any business venture. The court found that the Florida legislature could have "reasonably anticipated" Lee Memorial's anticompetitive conduct in granting Lee Memorial the power to acquire other hospitals. Lee County, 38 F.3d at 1192. The court therefore found that Lee Memorial was entitled to immunity under Parker.

- Jackson, Tennessee v. West Tennessee, 414 F.3d 608 (6th Cir. 2005). In this case, the Sixth Circuit court carefully analyzed the authorizing legislation to determine whether the Tennessee law authorized the Jackson-Madison County General Hospital District, a hospital owned or operated by one or more local governments or a hospital authority created by a private act of the general assembly, to engage in anticompetitive actions. See Jackson, 414 F.3d 608. The court found that the legislature had in fact anticipated the anticompetitive acts and so were entitled to immunity.

- Crosby v. Hospital Authority of Valdosta and Lowndes County, 93 F.3d 1515 (11th Cir. 1996). In Crosny, a case involving a physician who was denied staff privileges at a Georgia hospital, cites the Lee County standard and test for foreseeability. See Crosby, 93 F.3d at 1532.

  Dr. Crosby, an osteopathic physician, sued the doctors on the peer committee and the Hospital Authority, alleging that they conspired to deny an osteopath privileges in restraint of trade and in an attempt to monopolize the staff positions for allopathic physicians. The Hospital Authority, like Lee Memorial, was created pursuant to a statute, Georgia's Hospital Authorities Law, O.C.G.A. § 31-7-70 et seq. (2006). The Hospital Authority was endowed with all of the powers necessary to operate a hospital, the right to sue and be sued, to execute contracts, to exercise the right of eminent domain, among others. See Crosby, 93 F.3d at 1519 (citing O.C.G.A. § 31-7-75). The 11th Circuit traced the history of the state action doctrine and concluded that the Hospital Authority was a political subdivision of the State of Georgia. This finding eliminated the active supervision requirement. The Court then examined whether the clear articulation prong of the Hallie test had been satisfied. To determine whether the anticompetitive conduct was foreseeable, the Court relied on the "reasonably anticipated" language from Lee County.

FTC Today

Former FTC Chairman Timothy Muris, 2000-2004, was particularly interested in state action cases. Muris formed a State Action Task Force in June 2001 to examine the scope of the state action doctrine. The Task Force's report, issued in September 2003, concluded that both the clear articulation and active supervision requirements had been broadly interpreted. Various Circuit Courts have inferred clear articulation of the state's policy from the grant of the power to make acquisitions, enter into contracts and other general corporate powers. The Task Force recommended, and the FTC is working, to narrowly tailor the clear articulation standard and to

strengthen the active supervision standards. Recent cases brought by the FTC highlight these trends.

In 2003, the FTC challenged the actions of the South Carolina Board of Dentistry ("Dentistry Board") on the grounds that it had unlawfully restrained competition by promulgating an emergency regulation that unreasonably restricted the ability of dental hygenists to treat patients. South Carolina Board of Dentistry v. FTC, 455 F.3d 436 (4th Cir. 2006), the South Carolina Board of Dentistry ("Dentistry Board") claimed it was immune from suit by the FTC under state action immunity. The FTC concluded that the Dentistry Board could not satisfy the clear articulation requirement. The Dentistry Board filed an interlocutory appeal to the Fourth Circuit, which held that state action immunity was not immediately appealable. The Dentistry Board is in the process of petitioning for a writ of certiorari.

The FTC continues to pursue cases which clarify the active supervision requirement. Most of these cases turn on whether the level of supervision has been sufficient. The FTC has targeted household moving companies, namely Kentucky Household Goods Carriers Ass'n, Inc. v. FTC, Slip Copy, 2006 WL 2422843 C.A.6 (Aug. 22, 2006), among others. In the Kentucky Household Goods case, the FTC set forth criteria for determining active supervision "where the state collects business data (including revenues and expenses), conducts economic studies, reviews profit levels and develops standards or measures such as operating ratios, disapproves rates that fail to meet the state's standards, conducts hearings and issues written decisions." Id. In that case, there was not enough state supervision to merit the imposition of state action immunity. These benchmarks, though, have set a new standard for measuring the level of active supervision by the state.

Lee Memorial Today

The authorizing legislation for Lee Memorial was significantly amended in 2000. These revisions, though, did not change the language that authorizes Lee Memorial to acquire neighboring hospitals, sue and be sued, enter into contracts and to participate in or control any business venture the Board of Directors determines is in furtherance of the purposes and best interests of Lee Memorial. In effect, the legislature affirmed the 11th Circuit decision. Had they altered the language at all, or had included language that specifically provided that Lee Memorial was subject to the antitrust laws, the conclusion may have been different. In the absence of those actions, a court would almost certainly conclude the legislature intended Lee Memorial to be immune.

It is therefore highly likely that were the case to be re-litigated, the court would find Lee Memorial immune. While the FTC is generally interested in state action cases, it does not appear that this case has attracted any interest on the part of the FTC. It would therefore seem that the acquisition would not give rise to antitrust liability.