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FTC v. Phoebe Putney: A Reasonable Reliance Defense in the Brave New World of State Action Immunity



BY JOHN M. GORE, BETH HEIFETZ, AND TOBY G. SINGER

John M. Gore is an associate at Jones Day, Washington. His practice focuses on appellate advocacy and legal strategy in complex trial litigation, including a series of high-profile antitrust cases in the health care industry. He can be reached at jmgore@jonesday.com.

Beth Heifetz, a partner at Jones Day, Washington, has more than 25 years of experience in appellate litigation, representing clients in constitutional, tax, antitrust, securities, insurance, and bankruptcy matters. She can be reached at bheifetz@jonesday.com.

Toby G. Singer, a partner at Jones Day, Washington, is one of the nation's leading authorities on mergers and other antitrust matters in the health care industry. She represents providers and payers on issues ranging from mergers and acquisitions to less formal alliances among competitors. She can be reached at tgsinger@jonesday.com.

The views set forth herein are the personal views of the authors and do not necessarily reflect those of the law firm with which they are associated.

The Supreme Court's recent decision in *FTC v. Phoebe Putney Health System Inc.*, No. 11-1160 (Feb. 19, 2013), scaled back the availability of the state action immunity that local governments across the country have relied upon for decades to shield their activities from federal antitrust scrutiny. In so doing, the Supreme Court opened the door to potential FTC and private challenges to countless consummated transactions involving such governments—including transactions undertaken at a time when the parties reasonably believed that the governing law entitled them to state action immunity. These potential enforcement actions not only expose parties to the risk of antitrust liability for transactions long closed, but also threaten to consume substantial resources even in cases where the defendants ultimately prevail on the merits.

Yet even though it limited the state action doctrine, the Supreme Court left open a crucial and potentially powerful line of defense in any backward-looking enforcement actions involving pre-*Phoebe Putney* transactions. Lower court cases not addressed, much less overruled, by *Phoebe Putney* long have recognized a defense for local governments and private parties that acted in the reasonable belief that state law immunized their activities from the federal antitrust laws. This reasonable reliance defense could take on significant new meaning if the FTC—consistent with a current trend—or private parties seek to challenge consummated transactions that the parties believed at the time were protected by the state action doctrine.

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I. *FTC v. Phoebe Putney: A Demanding Standard for State Action Immunity*

The Supreme Court long has held that local governmental entities enjoy state action immunity from the federal antitrust laws when they act pursuant to ''a clearly articulated and affirmatively expressed'' state policy to displace competition[1] and has applied a foreseeability test to determine whether such a clear articulation has occurred, *see Town of Hallie v. Eau Claire*, 471 U.S. 34, 42–43 (1985).[2] In *Phoebe Putney*, the court rejected the Eleventh Circuit's holding that the foreseeability test required only that anticompetitive conduct was the ''foreseeable result'' of the state's grant of authority to the local government.[3] Rather, the court adopted the FTC's narrow view that ''the displacement of competition'' must have been ''the inherent, logical, or ordinary result of the exercise of authority delegated by the state legislature.'' [4]

In other words, ''the State must have foreseen and implicitly endorsed the anticompetitive effects as consistent with its policy goals.'' [5] The court further clarified that a legislature's extension to a local government of powers that ''mirror general powers routinely conferred by state law upon private corporations''—such as the authority to enter leases or acquisitions—does not satisfy the foreseeability test.[6] Indeed, because such general powers ''typically are used in ways that raise no federal antitrust concerns,'' a state that has delegated them ''can hardly be said to have 'contemplated' that they will be used anticompetitively.'' [7]

Although the court stopped short of requiring an express statement to confer state action immunity, the implication of *Phoebe Putney* is clear: a local government must point either to such a statement or some other evidence that the state legislature granted it ''authority to act or regulate anticompetitively.'' [8] This narrowing of the state action doctrine extends beyond public hospital authorities like Phoebe Putney, and may call into question the state action immunity of local governments and private actors engaged in such varied activities as electrical inspection and environmental protection.[9] And because, as discussed below, FTC and private challenges to consummated transactions are possible—and have become increasingly common in recent years—local governments and private actors may find themselves embroiled in challenges to completed transactions previously believed to be immune from the federal antitrust laws.

II. FTC and Private Actions Against Consummated Transactions: ''An Increasingly Important Part of'' Federal Antitrust Enforcement

The FTC has authority to enforce Section 7 of the Clayton Act, which prohibits mergers whose effect ''may be substantially to lessen competition, or to tend to create a monopoly.'' [10] The FTC may challenge even a consummated merger at any time because the Clayton Act lacks a statute of limitations for public enforcement actions.[11] As one FTC commissioner recently noted, ''consummated merger investigations have in recent years become an increasingly important part of the FTC's caseload.'' [12]

In the three-year period from March 2009 to March 2012, the FTC challenged nine consummated transactions, and ''[c]onsummated merger challenges made up about one-fifth of [the FTC's] total merger challenges.'' [13]

These ''[a]gency challenges to consummated mergers are far more likely to result in litigation than challenges to unconsummated mergers'' because the parties have every incentive to preserve a consummated transaction, while agencies can tap into evidence of actual post-merger effects.[14] In fact, the 2010 Merger Guidelines—which ''for the first time address the topic of consummated mergers'' [15]—direct that ''[e]vidence of observed post-merger price increases or other changes adverse to customers is given substantial weight'' and may ''be dispositive'' [16] even in the absence of any effort by the agency ''to define the relevant market or determine concentration levels.'' [17]

The FTC's trend of mounting challenges to consummated transactions was on full display in *Evanston Northwestern*, where the FTC challenged a private hospital merger four years after it initially declined to challenge the merger based on the parties' Hart-Scott-Rodino filings.[18] Examining ''not only pre-merger evidence, but also evidence about what happened after the merger,'' the commission concluded that the merger had resulted in higher prices and other anticompetitive effects and therefore ordered injunctive relief.[19] And in *Chicago Bridge & Iron Co. v. FTC*, the FTC even went so far as to seek—and it obtained—divestiture of assets acquired in a completed merger shown to be anticompetitive after the fact.[20]

Private plaintiffs also may bring suit challenging a consummated merger under section 7 of the Clayton

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[1] *Community Commc'ns Co. v. Boulder*, 455 U.S. 40, 52 (1982).

[2] Private actors also may qualify for state action immunity on a showing that their activities are authorized by ''clearly articulated and affirmatively expressed state policy'' and that the policy is ''actively supervised by the State.'' *Cal. Retail Liquor Dealers Ass'n v. Midcal Aluminum Inc.*, 445 U.S. 97, 105 (1980).

[3] *See Phoebe Putney* Slip Op. at 4.

[4] *Id.* at 11.

[5] *Id.*

[6] *Id.* at 9.

[7] *Id.* at 9–10.

[8] *Id.* at 10.

[9] *See, e.g.*, *Cal. CNG Inc. v. So. Cal. Gas Co.*, 96 F.3d 1193 (9th Cir. 1996); *Elec. Inspectors Inc. v. Village of East Hills*, 320 F.3d 110 (2d Cir. 2003).

[10] 15 U.S.C. § 18.

[11] *See United States v. E.I. du Pont de Nemours & Co.*, 353 U.S. 586 (1957).

[12] J. Thomas Rosch, Commissioner, FTC, Address to ABA Section of Antitrust Law Spring Meeting: Consummated Merger Challenges—The Past Is Never Dead at 1 (March 29, 2012), *available at* http://www.ftc.gov/speeches/rosch/120329springmeetingspeech.pdf (Rosch Address).

[13] *Id.* at 2.

[14] *Id.* at 2–3.

[15] *Id.* at 9.

[16] 2010 Merger Guidelines § 2.1.1.

[17] Rosch Address at 10.

[18] *See* Op. of Comm'n at 4, *In the Matter of Evanston Northwestern Healthcare Corp.*, FTC Docket No. 9315 (Aug. 6, 2007).

[19] *See id.* at 4–5.

[20] *See* 515 F.3d 447, 477–78 (5th Cir. 2008).

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Act or other antitrust provisions such as section 2 of the Sherman Act. Thus, for example, a group of private plaintiffs filed suit challenging the Evanston Northwestern merger shortly after completion of the FTC's administrative proceeding.[21]

To be sure, many hurdles remain to FTC and private enforcement actions brought against consummated transactions undertaken by local governments under the belief that state action immunity attached to the transaction. The FTC has limited resources, and the FTC or private plaintiffs may not have sufficient proof of all of the elements of their claims. Moreover, private enforcement actions are subject to a four-year statute of limitations, although that period is tolled by the commencement of a government enforcement action.[22] And under the Local Government Antitrust Act, a private party may not recover money damages against a local government.[23]and courts may be reluctant to order divestiture—the most extreme form of equitable relief in a merger case—against a local government for a consummated transaction. Nonetheless, the Supreme Court's narrowing of the state action doctrine in *Phoebe Putney* shortens at least one significant hurdle to challenges to consummated transactions involving local governments, and there remains the very real possibility that local governments and even private parties may be caught up in this ''increasingly important part of'' federal antitrust enforcement.[24]

III. Reasonable Reliance: A Defense for Consummated Transactions

There appears to be no case addressing whether a change in the foreseeability test is retroactive, and operates to strip a local government or private party of state action immunity for past actions that qualified for immunity at the time they were undertaken but fail the new iteration of the test. A few courts, however, have addressed whether an entity enjoys state action immunity for actions authorized by a state law that is later repealed or invalidated. The courts have held that the state action immunity continues to apply to actions undertaken prior to the repeal or invalidation.[25]

Indeed, the Tenth Circuit has squarely held that ''there should be a defense for those reasonably relying on the appearance of legality when a state agency's exercise of power is unauthorized.'' [26] As Judge (now Justice) Anthony M. Kennedy reasoned, ''[a] state's antitrust immunity springs from an essential principle of federalism, [so] it follows that actions otherwise immune should not forfeit that protection merely because the state's attempted exercise of its power is imperfect in execution under its own law.'' [27]

Although these cases address whether the state legislature had authorized the local government to act and not whether the legislature had authorized anticompetitive effects, these cases strongly suggest that a local government or private actor ''should [have] a defense for . . . reasonably relying on the appearance'' that state action immunity attached to its actions.[28] Indeed, such entities ''should not forfeit th[e] protection'' of state action immunity ''merely because the state's attempted exercise of its power'' to authorize anticompetitive effects ''is imperfect in execution'' under the Supreme Court's after-the-fact construction of the foreseeability test.[29]

A local government or private actor may point to a number of facts to bolster its reasonable reliance defense, including:

1. Court decisions extending state action immunity to the entity under a prior incarnation of the foreseeability test;[30]
2. The state legislature's or executive branch's acquiescence in the local government's or private party's allegedly anticompetitive activities, including any reaffirmation of the local government's authority to act after a judicial recognition of state action immunity;
3. The text and history of the authorizing legislation, including any indication that the legislature was concerned with solving a specific local problem, not with advancing the goals of federal antitrust law; and
4. Any provisions of state law guaranteeing that the local government's exercise of its authority is politically accountable, such as the involvement of elected officials in the decisionmaking process or open meeting and records requirements.[31]

IV. Conclusion

Thus, while *Phoebe Putney* calls into question the state action immunity of numerous local governments and private parties—and even opens the door to revisiting long-completed transactions—it leaves undisturbed the reasonable reliance defense, which may continue to provide these entities a shield against federal antitrust liability for consummated transactions.

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[21] *See Messner v. Northshore University HealthSystem*, 669 F.3d 802 (7th Cir. 2012).

[22] *See* 15 U.S.C. §§ 15b, 16(i).

[23] *See id.* §§ 34–36.

[24] Rosch Address at 1.

[25] *See, e.g.*, *Llewellyn v. Crothers*, 765 F.2d 769 (9th Cir. 1985) (Kennedy, J.); *Lease Lights Inc. v. Pub. Serv. Co.*, 849 F.2d 1330 (10th Cir. 1988); *Cal. CNG Inc.*, 96 F.3d 1193; *Elec. Inspectors Inc.*, 320 F.3d 110.

[26] *Lease Lights*, 849 F.2d at 1334.

[27] *Llewellyn*, 765 F.2d at 774; *see also* 1A Areeda & Hovenkamp, *Antitrust Law* § 228d, at 223 (2006) (''If the private defendant's challenged conduct is the result of reasonable reliance on apparently lawful or even ambiguous government action, the immunity from treble damages should be available.'').

[28] *Lease Lights*, 849 F.2d at 1334.

[29] *Llewellyn*, 765 F.2d at 774.

[30] *Compare, e.g.*, *Lease Lights*, 849 F.2d at 1334 (invoking prior court decision recognizing authority to act under state law).

[31] *See, e.g.*, *Town of Hallie*, 471 U.S. at 45 (a political subdivision is presumed to ''act[] in the public interest'').