Fordham Urban Law Journal

Volume 12 | Number 3 Article 1

1984

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Cover Page Footnote
Comments of Wayne D. Collins, Robert McGuckin, Phillip Warren, and the editors of the Fordham Urban Law Journal are most appreciated.

LOCAL GOVERNMENT ACTION AND ANTITRUST POLICY: AN ECONOMIC ANALYSIS

*Timothy J. Brennan**

I. Introduction

At least partly as a result of the Supreme Court decision in *Community Communications Co. v. City of Boulder*,[1] cities are facing antitrust challenges to their rights to franchise cable television systems.[2] Other municipal activities have been similarily challenged.[3] The prospect of costly and uncertain antitrust litigation challenging local government actions will restrict the scope and extent of local regulatory activity. Such restriction could, in turn, preempt city residents' ability

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1. 455 U.S. 40 (1982).

2. *See, e.g.*, Omega Satellite Products Co. v. City of Indianapolis, 694 F.2d 119 (7th Cir. 1982); Berkshire Cablevision of Rhode Island, Inc. v. Burke, 571 F. Supp. 976 (D.R.I. 1983); Hopkinsville Cable TV, Inc. v. Pennroyal Cablevision, Inc., 562 F. Supp. 543 (W.D. Ky. 1982).

3. *See, e.g.* Central Iowa Refuse Systems, Inc. v. Des Moines Metropolitan Solid Waste Agency, 715 F.2d 419, 424, 426-27 (8th Cir. 1983) (metropolitan waste agency qualified for state action exemption); Omni Outdoor Advertising v. Columbia Outdoor Advertising, Inc., 566 F. Supp. 1444, 1446 (D.S.C. 1983) (municipal corporation engaged in erecting and leasing of billboards not exempt from liability under Sherman Act); Capital Telephone Co., Inc. v. City of Schenectady, 560 F. Supp. 207, 210 (N.D.N.Y. 1983) (municipal authority to grant franchises not subject to antitrust laws); Gold Cross Ambulance & Transfer v. City of Kansas City, 705 F.2d 1005 (8th Cir. 1983) (contesting municipal provision of ambulance service); Hanky v. City of Richmond, 532 F. Supp. 1298 (E.D. Va. 1982) (contesting zoning decision denying right to build hotel); Wyatt v. City of Pensacola, 196 So. 2d 777 (Fla. Dist. Ct. App. 1967) (invalidating zoning ordinance excluding new dry cleaning business for 3 years).

Zoning by definition restrains trade by means of restrictions which affect commercial land use. *See* Note, *Antitrust and Zoning—How Much Respect For Local Government?*, 22 SANTA CLARA L. REV. 901, 903 (1982). Zoning actions which exclude certain business uses or preclude business use by all but a single user have been challenged under state antitrust laws, *id.* at 904-07, and are susceptible to attack under the Sherman Act (codified at 15 U.S.C. §§ 1-7 (1976)). *Id.* at 907. *See also* Stauffer v. Town of Grand Lake, Civ. Action No. 80-A-752, slip op. (D. Colo. Dec. 15, 1980).

to choose, through their elected representatives, the goods and services they prefer.[4]

This Article proposes that as a matter of policy the burden of proving a municipal antitrust violation should be on those who seek to restrict municipal action. The necessary limitations on municipal antitrust liability can be properly identified by analogizing city actions to private economic actions. This perspective is consistent with the assumptions required to judge policies by their predicted economic effects.[5] This Article discusses the merits behind the general case for municipal antitrust immunity and the specific circumstances in which cities might face liability under antitrust laws.

Part II of this Article sets out three criteria by which the potential for adverse effects of a city's action may be determined.[6] These criteria are derived from the principles underlying the presumption that independent individual decisions lead to economic outcomes that are preferable to those achieved through central planning.[7] Of particular importance and complexity is the determination of when a locality's public decision-making procedures appropriately reflect the views of its residents.[8] The practical application of these criteria is illustrated by a simplified example of cable television franchising.[9] Part III assesses the leading "state action" cases using the criteria developed in Part II.[10] This case law emphasizes the propriety of decision-making

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4. *See* Comment *Alternative Approaches to Municipal Antitrust Liability*, 11 FORDHAM URB. L. J. 51, 52-53 n.12 (1983) (discussing uncertainty of municipal antitrust liability after *Boulder*).

5. *See infra* notes 13-18 and accompanying text for a discussion of these assumptions.

6. These criteria can be expressed as three questions: (1) would it be more efficient to have a single decision on the issue made for all cities than to have each city make its own?, *see infra* notes 22-26 and accompanying text; (2) would a single-decision maker be adequately motivated to reflect the desires of each city's residents?, *see infra* notes 27-60 and accompanying text; and (3) would a single decision better protect the interests of those who do not reside in the city? *See infra* notes 61-71 and accompanying text.

7. It is important to emphasize at the outset that these criteria are derived from the normative assumption that people ought to receive what they desire to purchase and what they are willing and able to pay for. This assumption is not universally applicable. Arguably, in some cases the citizens' ability to make choices should be constrained by the state because of incompetence (e.g., proscribing certain medical treatments) or because such actions are morally unacceptable (e.g., proscribing race discrimination). Where significant non-economic concerns are pertinent to an issue, they should be given serious consideration.

8. *See infra* notes 27-31 and accompanying text.

9. *See infra* notes 72-81 and accompanying text.

10. *See infra* notes 83-146 and accompanying text.

procedures and neglects the effects on those citizens outside the locality. Further, the Supreme Court's distinction between state and city activity cannot be justified under the derived criteria.[11] Part IV describes appropriate policies for dealing with potentially inefficient city actions and makes specific recommendations consistent with the current case law.[12]

II. Economic Criteria for Federal Restriction of Municipal Activity

A. General Principles

The theorems of economic analysis that speak to the optimal welfare properties of competitive allocations do not mention decentralized, "free market" institutions. The theorems themselves are consistent with central planning. Much of this theory's development has derived from economists who are less concerned with true market performance but more interested in how a central planner should instruct its managers to behave. Indeed, some economists have criticized these "efficiency" notions and theorems on the grounds that they lend false credence to the view that a central planner can completely manage an economy.[13]

The choice to rely on decentralized rather than centralized decisions does not flow from the fundamental efficiency theorems of economic analysis.[14] Rather, its support in economic theory is drawn

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11. *See* text following *infra* notes 121 & 134.

12. *See infra* notes 147-69 and accompanying text.

13. For example, a central planner could set prices and cause consumers and firms to act competitively; that is, take prices as given when making purchase or production decisions. The planner, rather than the marketplace, could theoretically adjust prices to correct supply or demand imbalances. *See* Lange, *On The Economic Theory of Socialism*, in M. GOLDMAN, COMPARATIVE ECONOMIC SYSTEMS 21 (1971). Much of the argument is that the idealistic view of the ability of the central planner to allocate resources efficiently neglects the practical problems involved in the allocation. These problems are described in *infra* notes 14-17 and accompanying text. *See* Demsetz, *Information and Efficiency: Another Viewpoint*, 12 J. LAW ECON. 1, 19 (1969); Rizzo, *Uncertainty, Subjectivity and the Economic Analysis of Law* in TIME, UNCERTAINTY AND DISEQUILIBRIUM 71, 81 (M. Rizzo ed. 1979).

14. There are two major optimality theorems. The first is that goods are allocated "efficiently" in a "competitive" context. Here, "competition" is defined as an environment in which consumers and firms act as if they have no influence on price. This passive, "price-talking" behavior is different from the "competitive" behavior of an active contest among various contenders for a reward. The relevance of this conception is that in ideal markets there are so many consumers and firms (either actual sellers or potential entrants) that no one of them can affect price through its

from three assumptions. First, decentralized decision-making coordinated through price signals can process the preference and cost information necessary to make effective allocations more efficiently, primarily because it avoids the costs involved in centralizing this information.[15] Second, those affected by the outcome of an economic decision have the most incentive to take actions that maximize their economic welfare. The free market, supported by private property rights, provides this incentive by ensuring that the rewards from the efficient allocation of a commodity flow to the agent having the power to determine how it is used.[16] Third, no inefficiencies are induced by adverse effects on those who are not parties to the decision. One of the standard sources of "market failure" involves externalities; decisions by agents which affect others who cannot "signal" their preferences through the market mechanism.[17].

These assumptions may be illustrated by an example. Suppose X wants to buy a car from Firm Y. The economist normally assumes that X should be allowed to buy that car. It is assumed that X knows whether the car satisifies his needs, Firm Y has the incentive to maximize the welfare of its stockholders, and no one else is affected by the transaction. However, suppose that either (1) it is too costly for X to satify himself that the car meets minimum acceptable performance standards, (2) Firm Y is known (somehow) to be inherently wasteful, or (3) Z will become ill from breathing the fumes from X's new car.

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own relatively insignificant supply or demand decisions. "Efficiency" in this discussion means that there is no way to reallocate goods to make someone better off without making someone else worse off. This notion of "efficiency" is compatible with virtually any income distribution from perfectly egalitarian to one person owning all goods. The second theorem states that any efficient allocation of goods can be achieved by redistributing wealth and then letting the competitive market run its course. For the formal statement of these theorems, *see generally* G. DEBREU, THE THEORY OF VALUE 94-96 (1959). *See also* A. ATKINSON & J. STIGLITZ, LECTURES IN PUBLIC ECONOMIES 343 (1980) (less formal presentation of the theorem).

15. In essence, centralization is unnecessary because the information can be used at its sources: the consumers and firms who enjoy the benefits and bear the costs of economic decisions. *See* I. KIRZNER, COMPETITION AND ENTREPRENEURSHIP 230 (1973).

16. *See* R. POSNER, ECONOMIC ANALYSIS OF LAW 10 (1973).

17. *See* E. MANSFIELD, MICROECONOMICS 372 (1979). POSNER, *supra* note 16, at 52, defines an externality as something outside of the decision-making process. Posner cautions that "if 'externality' is defined as external to market processes of decision rather than to the injurer, it is still a misleading usage because low transaction costs may enable the market to operate efficiently despite the presence of externalities. *Id.* An externality is created "when an activity by one or more parties affects, for good or bad, another one or more parties who are not a part of, or are external to, the activity." ENCYCLOPEDIA OF ECONOMICS 357 (D. Greenwald, ed. 1982).

Under (1), the assumption that individual consumers know their needs best could be violated and could warrant centralized imposition of minimum standards. Under (2), the assumption that nominal owners have the incentive to look out for their best interests may be violated, justifying in some circumstances laws requiring certain fiduciary responsibilities of firm officers to stockholders. Under (3), an outside party is affected; if private transaction costs are high enough, imposition of an anti-pollution tax may be warranted.[18] Hence, we see that if any of these assumptions are violated, we can no longer guarantee that decentralized action leads to the most efficient outcome.

B. Application to Municipal Action

If reliance on decentralized decision-making is based on the high costs of centralizing information and the provision of proper incentives to maximize values by putting decisions in the hands of the affected parties,[19] application of this principle to collective decisions dictates that a decision be made by a group no larger than the set of agents potentially affected by the outcome of the decision.[20] Consequently, without further analysis, the theoretical presumption consistent with economic reasoning is that federal intervention in a matter affecting only the citizens within a smaller governmental unit is unwarranted.[21] Three justifications arguably overcome the presumption and warrant consideration.

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18. *See* MANSFIELD, *supra* note 17, at 378.

19. Another possible reason for decentralizing decision-making is that if A is not affected by B's actions, A arguably has no justification to interfere with B's choices. Although many economists share this belief in classical liberalism, it will be neglected in this discussion to maintain the focus on the more strictly economic considerations of costs and incentives. A recent statement of this view is R. NOZICK, ANARCHY, STATE AND UTOPIA (1975). *See also* A. SEN, COLLECTIVE CHOICE AND SOCIAL WELFARE 79-80 (1970).

20. More precisely, there is a point at which there is likely to be a tradeoff between dispersing information within this group and ensuring that the group includes all potentially affected parties. The optimal group, then, generally would be smaller than the set of all affected parties. *See* J. BUCHANAN & G. TULLOCK, THE CALCULUS OF CONSENT 113 (1962). Since the issue before us, however, is whether a larger group, the United States, should make decisions affecting a smaller group, a city, the principle that all affected parties should participate in the decision should control.

21. This statement is based on the theoretical application of the presumptions stated in *supra* notes 19-21 and accompanying text. It is not a factual argument for reliance on decentralized decision-making.

1. *Economies of Expertise*

The first argument in favor of federal intervention is that there may be economies of centralizing expertise. For some decisions based upon technical information, it may be costly for each municipality to supply the necessary expertise. Economies of scale in acquiring, processing, and evaluating information may warrant centralization of some decisions.[22] For example, if it is less costly for the federal government to evaluate the effects of certain pollutants than for each locality to perform the research, it could be more efficient to have federal government regulation rather than force each locality to independently study the problem and set appropriate policies.[23]

Municipalities can and do employ experts to make determinations when they judge the issues to be within their areas of concern, but beyond their own expertise.[24] Thus, even if there are economies inherent in compiling and handling large quantities of complex information, an advocate of federal intervention must justify the federal government's assumption of the role of the effective decision-maker. Rather than restrict local government activity, the federal government could provide its expertise at marginal cost to the cities.[25] This could be accomplished, for example, through general publications, specific comments or regulatory filings.[26]

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22. This is analogous to an argument that some "individual" decisions are best made by government. As illustrated in the example discussing automobile purchases and air pollution, text preceding *supra* note 18, a potential rationale for some so-called "consumer" legislation is that purchasing decisions require knowledge and ability that can be acquired collectively by the government at less expense than if each individual consumer did the same research. The argument against this kind of protective legislation, however, is that the market can supply the needed information and consumers can utilize outside expertise on their own if they so choose. This response also applies to legislation intended to protect cities or states from potential problems.

23. *See, e.g.*, Hartman, *Alternatives for Regulatory Control of Acid Rain in the Northeastern United States*, 11 FORDHAM URB. L. J. 455, 460-61 (1983) (discussing federal agency research, funding and program development to enforce Clean Air Act).

24. *Id.* at 481 (interstate monitoring of air quality by EPA experts).

25. *See infra* notes 147-51 and accompanying text.

26. If cities or localities have significantly unusual problems, it is less likely that the federal government can find less expensive solutions than those listed. This rationale favoring federal intervention would apply only to problems which are common throughout a broad class of localities. *See, e.g.*, Shabecoff, *U.S. Prohibits Use of Pesticide Tied To Animal Cancer*, N.Y. Times, Feb. 4, 1984, at 1, col. 6 (Environmental Protection Agency (EPA) suggested safe guideline levels of pesticide EDB in grain products while avoiding mandatory limits; states allowed to set individual limits based on EPA data and state's own findings).

2. *Procedural Integrity*

a. Theory

The second argument for federal intervention is that collective decision-making through the typical municipal mechanism does not reflect the preferences of local constituents.[27] There are many reasons why this may be so. The method of majority rule, whatever its other virtues or flaws as a social choice mechanism,[28] does not permit the direct comparisons of valuation which are available through bids in a market.[29] Of course, if the number of votes or the nature of post-election decisions are influenced through monetary expenditure,[30] this flaw may be somewhat less important from an economic perspective.[31] Another problem is that voters typically choose from only a few candidates who take positions on a large number of issues, thereby making specific valuations on single issues difficult to represent electorally. In addition, it is difficult to monitor the performance of elected or appointed officials to ensure that their behavior reflects the preferences of the electorate. For example, a local power commission may give greater consideration to the interests of the electric company's stockholders than to the more diffuse needs of the electricity users.

Despite significant evidence of local government malpractice, it is difficult to prove that federal government intervention will result in systematic improvements.[32] When municipal government mechanisms lead to predictably inefficient behavior, however, restriction of municipal authority may be warranted.[33] An obvious theoretical

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27. This theory is analogous to the claim that a decision-maker may not have the incentive to act in the best interests of those affected by its decisions.

28. *See* SEN, *supra* note 19, at 72, 184.

29. Examples of factors which have indirect influence within the voting process include lobbying and campaign contributions.

30. Voting supplies "A" or "B" type statements, but it offers little guidance concerning the relative levels of commitment among A and B supporters. Theoretically, a minority strongly supporting A would be willing to pay a majority supporting B enough to change the majority to support A. Even though politicians compete for votes, simple elections cannot provide a venue to make these other economic tradeoffs to achieve efficient social choices.

31. *See* BUCHANAN & TULLOCK, *supra* note 20, at 154. The authors argue that the economic distortions of the sort described in *supra* note 29 and accompanying text can be reduced through side payments among voters.

32. *See generally*, G. STIGLER, THE CITIZEN AND THE STATE (1975).

33. *See supra* note 14. As noted in the automobile example, text preceding *supra* note 18, private institutions may not fully reflect the preferences of their "constituents."

problem is that the congressional, executive and judicial bodies which create federal restrictions on local activities are national in scope.[34] The problems inherent in the electoral process[35] appear even more severe at the national level. The mere identification of local imperfections does not, by itself, justify federal intervention.

b. Application

The problem of applying a procedural integrity criterion raises an important question: by what standard does one decide that local political institutions are misrepresenting their constituents? Since this question does not appear to have a totally satisfying answer, the best one can do is analyze the advantages and disadvantages of probable answers. This Article will argue that the optimal choice among the unsatisfactory alternatives is to find misrepresentation only when established political procedures are being subverted.[36]

i. General Ethics

Arguably, local political institutions fail when they do not produce the distribution of goods within a locality that "best" merges the needs of the citizens with principles of distributive justice, allocative efficiency and ethical rights. Under a criterion of general ethics, "failure" would be a relative term which compares the achieved result to an ethical model of this "best" condition. Given the normative aspect of the term "failure" in this context, it is not surprising that federal intervention in state or local affairs might be justified by appeals to broad ethical considerations.

This concept of "failure" is central in designing constitutions and legislative actions to avoid it.[37] Some commentators have suggested that these considerations may be relevant in judicial decisions as well.[38] Considering the uncertainties and disagreements regarding both ethical theories and the practical issue of whether the central

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34. For purposes of this Article, the right of private antitrust action against municipalities is interpreted as essentially a grant by Congress to private parties to restrict local action as interpreted by federal executive agencies and courts. *See generally*, J. NOWAK, R. ROTUNDA, J. YOUNG, HANDBOOK ON CONSTITUTIONAL LAW 121-37 (2d ed. 1983) (discussing establishment of legal basis for federal authority).

35. *See supra* notes 27-31 and accompanying text.

36. *See infra* notes 50-51 and accompanying text.

37. For example, one might argue that the Bill of Rights is intended to ensure an ethically justifiable distribution of basic political and civil rights to each individual. *See* U.S. CONST. amends. I-X.

government is more or less likely to perform normatively better than local governments, this Article will adopt a narrow approach to the antitrust liability question.

ii. Efficiency

Government decision-making is not the only category of action that may be subjected to ethical analysis. Private actions, either individual or collective, may also be so analyzed. The broad range of ethical issues is not usually considered when deciding whether to impose antitrust liability.[39] For example, the social propriety of consuming alcohol would not be relevant to a prosecutor or judge who must argue or decide whether to permit a merger that might reduce beer supplies.[40] A more useful antitrust consideration is the recognition of the social interest in maximizing the economic value of society's total output, regardless of such ethical considerations.[41] Moreover, unlike alternate objectives such as the protection of small business to preserve individual autonomy and the entrepreneurial spirit, it is alleged that economic efficiency has the virtues of being operational, well defined and objectively verifiable.[42]

It is questionable whether a strict efficiency analysis possesses these advantages when it is applied to the actions of local governments. The operational value of the efficiency standard is derived largely from the assumption that by focusing on only the supply and demand schedules in the relevant market, a court has all the information required to judge the efficiency of an industry practice. The chief problem with this standard is its neglect of externalities.[43] For example, courts

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38. *See Dworkin, Hard Cases*, in TAKING RIGHTS SERIOUSLY (1977); C. FRIED, CONTRACT AND PROMISE (1981).

39. *See* R. POSNER, ANTITRUST LAW: AN ECONOMIC PERSPECTIVE 8-22 (1975) [hereinafter cited as ANTITRUST LAW].

40. *See* United States v. Falstaff Brewing Corp., 410 U.S. 526 (1973) (allowing Falstaff, a principal national beer distributor, to enter the New England market by acquiring the region's largest seller of beer). The Court did consider "temperance" as a potential justification for a California program maintaining wholesale prices for wine, but rejected it on empirical grounds. California Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc., 445 U.S. 97, 112. See *infra* notes 125-31 and accompanying text for a discussion of the *Midcal* case.

41. *See* Baxter, *Separation of Powers, Prosecutorial Discretion, and the "Common Law" Nature of Antitrust Law*, 60 TEX. L. REV. 661, 693 (1982).

42. *See* R. BORK, THE ANTITRUST PARADOX 71-89 (1978).

43. See *supra* note 17 and *infra* notes 67-77 for a discussion of externalities. This argument was offered in defense of the National Association of Broadcaster's Code

would probably not excuse an otherwise illegal hypothetical steel monopoly merely because monopolistically reduced steel output resulted in a decrease in air pollution and a net increase in economic welfare.[44]

There are two arguments against incorporating such externalities into antitrust case analysis. First, the inclusion of externalities requires consideration of factors for which there is, by definition, no market in which to evaluate their consequences.[44] Therefore, the operational usefulness of the efficiency criterion is greatly reduced. Second, it can be argued that policies which compensate for externalities are the proper province of direct legislative action through taxing authority and regulatory agencies, rather than indirect influence through discretionary nonenforcement of the antitrust laws.

The paradox is that the city or state under scrutiny *is* the agency that is expected to recognize, evaluate and control the supply and effects of externalities in public policy decisions. Thus, determining whether a city's actions are efficient requires consideration of the same externalities which are generally ignored in antitrust analysis.[46] It must be noted that the set of externalities affecting a city may involve more than conventional effects such as pollution.[47] The supply of potential merit goods such as education or attempts to redistribute income through the tax system also can be included. When all externalities are considered, the usual efficiency standard retains little if any operational value.[48] Because cities or states themselves are the proper agencies for dealing with externalities, municipal antitrust

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limiting the number and duration of television commercials. The court rejected that argument in denying the defendant's motion for summary judgment. United States v. Nat'l Ass'n of Broadcasters, 536 F. Supp. 149, 161 n.48 (D.D.C. 1982). It should be noted that the root of the market failure was never specified. For a discussion of the relevant issue, see Brennan, *Economic Efficiency and Broadcast Content Regulation*, 35 FED. COMM. L.J. 117, 127 (1983).

44. See *supra* note 17 and *infra* notes 61-71 and accompanying text for a discussion of externalities.

45. *Id.*

46. *Id.*

47. Some externalities such as pollution may be partly controlled through zoning. *See generally*, W. VALENTE, LOCAL GOVERNMENT LAW 299-305 (2d ed. 1980) (discussing regulation of environmental concerns).

48. This result contrasts sharply with the typical antitrust case involving sellers of a particular commodity in which the consideration of externalities is a peripheral and insignificant issue. *See* notes 168-69 and accompanying text.

analysis cannot limit itself to conventional efficiency analysis.[49] The relevant market for city action includes the externalities. They must be considered despite the convenience of excluding them.

iii. Procedural Integrity

The central problem with both the broad ethical approach and the efficiency approach to government behavior is that they require the actual distribution of economic benefits to be compared against some normative standard. Finding such a normative standard which is both operational and acceptable is difficult. A potentially less problematic and more viable approach examines the procedures used to achieve particular outcomes rather than results.[50] Specifically, if municipal or state action were taken in reasonable accord with local democratic procedures, then federal intervention would not be appropriate.[51]

Fundamentally, the welfare inferences underlying the conventional efficiency criterion incorporate procedural criteria rather than actual outcome evaluation. This is because preference is inferred from choice and welfare from preference.[52] It is believed that if a consumer selects A over B when both are available, it is better for that consumer to obtain A because (1) people should have what they prefer and (2) people's choices reflect their preferences.[53] Under this interpretation, the use of an efficiency criterion itself relies upon procedural criteria.

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49. *See supra* notes 17 & 23 (discussion of externalities and the necessity for local decisions).

50. It has been argued that procedural or "historical" principles of justice are ethically superior to outcome or "end state" principles because the ethical value inheres in the process itself, such as freedom of exchange, rather than the actual distribution of goods. *See* NOZICK, *supra* note 19, at 149-64 (1975). This is not a universally shared view. Principles requiring equal distributions of wealth or "Rawlsian" principles requiring maximization of the welfare of the least advantaged in society are examples of well known "end state" views. *See* J. RAWLS, A THEORY OF JUSTICE (1971).

51. This argument assumes that a city or state procedure is appropriate. If, for example, a state rewrote its constitution to allow only landowners to vote, would federal intervention be justified? Of course, to the degree that the United States Constitution guarantees proper local electoral procedure, this question is moot. *See* NOWAK, ROTUNDA & YOUNG, *supra* note 34, at 765-92 (electoral franchise as a fundamental right).

52. A. SEN, CHOICE WELFARE AND MEASUREMENT 66-73 (1982) (discussing relationship between choice, preference and welfare).

53. *Id.* at 66 (discussing economists' interpretation of revealed preferences).

We also rely upon procedural criteria in less fundamental ways. Horizontal price fixing is regarded as bad not because a case-by-case study of price fixing reveals inefficiency but, rather, because it subverts a competition procedure which is expected to deliver goods to consumers more efficiently.[54] Vertical restraints are viewed more benignly because they do not appear to systematically threaten the integrity of the competitive allocation procedure.[55]

A hypothetical situation in which a private, non-governmental body has internal decision-making procedures that could be abused illustrates the relevance of decision procedures. When considering the actions of a diffusely-owned firm, it is generally assumed that the stockholders effectively control the organization and are unanimously interested in maximizing its profits.[56] The integrity of the firm's decision-making procedures is relied upon to infer, for example, that output by competitive firms is supplied up to the point where price equals marginal cost.[57] This assumption may not always be valid, however, and securities and corporation law may be viewed in part as attempts to protect the integrity of these decision-making procedures.[58] The assumption of homogeneous stockholder objectives can-

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54. United States v. Trenton Potteries Co., 273 U.S. 392, 396-97 (1927) ("[i]t does not follow that agreements to fix or maintain prices are reasonable restraints and therefore permitted by the statute, merely because the prices themselves are reasonable"). *See also*, ANTITRUST LAW, *supra* note 39, at 11; F. SCHERER, INDUSTRIAL ORGANIZATION AND MARKET STRUCTURE 497-502 (1980).

55. Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36 (1977), *remanded*, 461 F. Supp. 1046 (N.D. Cal. 1978), *aff'd*, 694 F.2d 1132 (9th Cir. 1982). The Court noted the existence of substantial scholarly and judicial authority supporting the economic utility of vertical restrictions. 433 U.S. at 57-58. *See also* SCHERER, *supra* note 54 at 582-94.

56. G. SEWARD & W. NAUSS, BASIC CORPORATE PRACTICE 97-104 (2d ed. 1977).

57. *See* P. SAMUELSON, ECONOMICS 435-36 (11th ed. 1980). The policy intent behind setting price equal to marginal cost is that (a) consumers, in their purchase decisions, will equate price to marginal benefit and (b) net economic benefit is maximized when the benefits generated by the marginal unit of output just equal that unit's production cost. *See* BRENNAN, *supra* note 43, at 123.

58. *See e.g.*, Securities Act, § 5(c), 15 U.S.C. § 77e(c) (1976) (registration statement must be filed before securities are offered to public for sale). It has been stated that the purpose underlying the registration requirement is the disclosure of information that is relevant to an investor's appraisal of the merits of a particular security. *See* W. CARY, CORPORATIONS: CASES AND MATERIALS, App. A, 68 (5th ed. 1979). *See also* N.Y. BUS. CORP. LAW § 702(b)(1) (McKinney 1963) (qualifies board of directors' rights to adopt by-law setting number of directors). This provision limits the directors' power to control the structure of the board unless such power has been granted by the stockholders. N.Y. BUS. CORP. LAW § 702(b)(1) note on legislative studies and reports (McKinney 1963).

not be applied as readily to municipalities, considering the city residents' diverse preferences regarding proper municipal behavior. Furthermore, it is easier for a dissatisfied stockholder to "leave" the firm by selling his stock and moving to another company by reinvesting than for a person to move to a city with policies more to his liking.

Unfortunately, we lack a political theory analogue to the efficiency theorems of welfare economies which would justify an inference of efficient performance from specific political procedures. It may be difficult to identify a city's or state's procedures before questioning whether they have been violated. Recognizing these problems, procedural integrity, rather than efficiency or general ethics, is the most useful way to decide whether cities are properly representing their citizens. While there are severe problems posed in applying a procedural integrity test,[59] the other criteria discussed above are insufficiently operational to arrive at a conclusion to endorse or reject federal intervention in local affairs. Although procedural integrity may appear undirected or unfamiliar, it is fundamental to conventional analyses of antitrust matters.[60]

3. *Externalities*

The third argument in favor of Federal intervention is that there may be "externalities" affecting parties outside the locality.[61] If these "externalities" are present, the affected outside parties can influence the relevant internal decisions only through a more encompassing level of government. The possible effects of local action on outside parties include a distributional effect resulting from changes in wealth caused by the action, and an efficiency effect resulting from changes in incentives caused by the action.[62] Moreover, efficiency effects resulting from the exercise of market power may be distinguished from those resulting from unpriced third party influences, such as air pollution. Because of its specific focus on market power, antitrust interven-

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59. For example, assumptions needed for policy making may not be valid in all cases, *see supra* note 58, or identifying a normative standard as a procedural goal may be difficult. *See supra* text accompanying note 50.

60. See *supra* notes 28-31 and accompanying text for a discussion of the effect of majority rule on the market.

61. See *supra* notes 17 and accompanying text for a definition of externalities.

62. There may be an additional distributional effect resulting from changes in wealth caused by the action. *See* SAMUELSON, *supra* note 57, at 762-68 for a discussion of income distribution and redistribution. However, from an economic policy perspective, this effect is of little interest.

tion would be appropriate only if the local action led to an exercise of market power against outside parties.[63]

An externality analysis can be applied to *Parker v. Brown*,[64] the seminal "state action" decision. In *Parker*, a cartel of California raisin growers was created under an act of the California legislature.[65] The court held that the growers' actions pursuant to the statute did not violate the Sherman Act or the commerce clause, although they would have been unlawful without the authorization of the state statute. Thus, the state's action immunized the growers from antitrust liability.[66] According to an externality analysis, the decision in this case was economically unwise. If we assume that California raisin growers had power in the United States market for raisins, this action created a predictable inefficiency affecting raisin consumers outside California. The only way out-of-state buyers could prevent this type of inefficiency would be to act through the federal government, since they cannot vote in California elections.

An externality analysis must be applied regardless of whether the alleged practice involves selling products to, or buying items from, those outside the locality. The raisin example in *Parker* is a clear case of a "seller" locality monopolistically exploiting parties outside the state.[67] A hypothetical example of market power on the "buying" side would be a "buyer" city which elected to purchase all of its concrete collectively. This city would likely gain significant power against nearby concrete plants, considering concrete's high transportation cost. Nevertheless, it is likely that the market power problems are more severe on the selling side than on the buying side. While consumers normally exhibit some continued willingness to pay as the price for a product increases,[68] suppliers are more likely to be highly sensitive to price because the long-term average cost is likely to be constant absent demonstrable, significant economies or diseconomies

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63. See *infra* notes 64-67 and accompanying text for a discussion of a case in which state statutes regulating the pricing and distribution of raisins constituted the externality.

64. 317 U.S. 341 (1943). See *infra* notes 83-94 and accompanying text for a discussion of *Parker*.

65. *Parker*, 317 U.S. at 350. See *infra* note 86 for a citation of the California statute at issue in *Parker*.

66. *See Parker*, 317 U.S. at 368.

67. See *Parker*, 317 U.S. at 350 for a discussion of the provision's potential effect on interstate commerce.

68. SAMUELSON, *supra* note 57, at 58-59 (willingness to pay will be limited to reduced quantities of the product as price increases).

of scale[69] and because sellers are often more mobile than final customers.[70] A municipality's exclusion of outside entry into its markets would have a significant external effect only if the potential entrants could not enter other local markets equally well.[71]

C. Cable Television As An Example

The operation of the various criteria for restriction of municipal activity can be illustrated by using cable television franchising as an example. Economic reasoning suggests that decentralized decision-making avoids costly centralizing of information and provides the correlation of the abilities and incentives necessary to produce efficient decisions,[72] assuming the absence of externalities.[73] This reasoning suggests that the central government should not interfere with the economic decisions of local governments unless there are (1) econo-

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69. Situations with persistent economies of scale tend to have just one firm in the market and are referred to as natural monopolies. *See* S. BREYER, REGULATION AND ITS REFORM 15 (1982).

70. If enough cities colluded, they could affect the market by taking away the alternate sales opportunities for the sellers. For example, assume there are ten sellers of cable television services, each seeking customers. Assume further that the entire country consists of 100 cities, each of which allows cable service installation only upon municipal approval. If all the cities collusively adopted the same contract terms under which they would allow cable installations, there would, in effect, be only one buyer. This would be a "monopsony" situation. *See* ENCYCLOPEDIA OF ECONOMICS, *supra* note 17, at 673 (a monopsony is a market structure with only a single buyer of a commodity or service); SAMUELSON, *supra* note 57, at 548-49. A monopsony situation is more commonly recognized in the case of a "company town" where the local residents, sellers of labor, face but a single buyer who controls their fate by its decision of whose services it will purchase. *Id.*

71. *See* Easterbrook, *Antitrust and the Economics of Federalism*, 26 J. OF L. ECON. 23, 45 (1983), for a discussion of potential state monopoly power. Easterbrook neglects the other two criteria outlined in this Article by assuming that poor performance by city governments will be held in check by competition among cities for residents. *Id.* at 34. Easterbrook's view of elastic consumer mobility implies that local private monopolists or cartels could not possess market power as well. This Article endorses the view that competition among cities for residents is at best a long-run phenomenon and it is not strong enough to ensure continued optimum government performance. Since relocation is slow and costly, encouraging government officials to act in ways to maximize the welfare of current residents is difficult. The post-*Parker* case law arguably responds to this problem by establishing procedural guidelines to increase the likelihood that local governments will effectively reflect the interests of their constituents. Easterbrook employs a similar but narrower view which focuses on the argument that regulators tend to be captured by the regulated. *Id.* at 27.

72. *See supra* notes 15-16 and accompanying text.

73. See *supra* note 17 for a discussion of externalities.

mies of expertise in selecting or regulating cable systems,[74] (2) predictable discrepancies between consumer preferences regarding cable television systems and the local decisions on the system's size, channel capacity, access requirements, or other characteristics,[75] or (3) efficiency-reducing effects on outsiders from the local cable franchising system or regulatory process.[76] The controlling issue is whether federal restriction of the local cable franchising authority can be rationalized by one of these three conditions.

Turning first to the informational economies, it can be argued that the choice of optimal cable service is so complex that the federal government should save the costs of repeated city decisions by setting uniform standards.[77] Cities, however, like other large economic entities, appear capable of soliciting whatever expert advice they require in making their decisions. In addition, unlike consumers, the parties ostensibly harmed by any perceived lack of information, the cities, have not demanded legislative protection.[78]

With regard to the "procedural integrity" point, an argument for federal limits on local government decisions is that problems with electoral procedures or with the monitoring of official performance will result in predictably inefficient local cable service. The arguments are inconclusive when applied to electoral procedure. Although in theory majority-rule voting may render minority interests underrepresented when compared to their willingness to pay,[79] the actual ability of special interest groups to influence voting outcomes may actually overemphasize a minority opinion. This argument might favor limiting city involvement in cable selection, but the need for public approval before disrupting public rights-of-way when laying cable lines and the need for competition at the franchise level make city involvement in cable selection inevitable.

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74. See *supra* notes 22-26 and accompanying text for a discussion of economies of expertise.

75. See *supra* notes 27-60 and accompanying text for a discussion of the procedural means for ensuring proper procedures to be employed in reconciling competing interests.

76. *See supra* notes 42-49 and accompanying text for a discussion of efficiency.

77. The author is aware of no support for this argument. *See infra* note 78 and accompanying text.

78. In part, this may be because cities receive guidance from the observation of others' selections and service. This situation can be compared to other areas to which federal consumer legislation protections have been applied. *See, e.g.*, Traffic and Motor Vehicle Safety, 15 U.S.C. §§ 1381-1431 (1976). The Congressional purpose in establishing Chapter 38 was to reduce traffic accidents and related deaths and injuries. Federal involvement in establishing safety standards and supporting research were components of the Congressional program. *Id.* at § 1381.

79. *See supra* note 30.

Arguably, it is difficult to prevent municipal officials from deriving benefits from the regulation of cable systems. This problem is better addressed through other restrictions on incumbents' behavior rather than antitrust penalties. Incumbents also could have an incentive to use a cable system for free publicity through mandatory coverage of municipal activities over public access channels. It is, of course, impossible to divorce this private interest from the potential public interest in having such proceedings televised. Possibly, any bias could be weakened by an "equal time" requirement, but this approach would probably be impractical because of interpretative difficulties.

The final case for intervention, the presence of inefficiency-creating "externalities," would be relevant if such an effect could be identified as the result of municipal cable franchising. Pertinent concerns regarding the output side are eliminated because the city's cable subscribers have significant authority over franchising through direct or indirect electoral control of the franchising body. Relevant concerns relating to the inputs into cable television can surface in two areas.

The first determinant, whether a given city can exercise market power in the cable system market, is unlikely to occur. While differing geographical locations may restrict direct competition, cities may manuever against each other as buyers in the cable system market to some extent. Additionally, the diversity of ownership in the cable market suggests that many firms are able to construct cable systems efficiently. The supply of cable systems of a given quality is, therefore, highly sensitive to price, thus limiting the ability of cities to reduce that price through negotiations.[80] Second, the city might permit its cable system to charge monopoly rates to programmers for the use of channels. Since some cable programmers may be willing to pay more than an economically efficient price for access to a local television market, this possibility cannot be readily dismissed and federal action to regulate access charges could be justified.[81]

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80. If a large group of cities colludes, the likelihood of monopsony becomes more likely. *See supra* note 76.

81. The Federal Communications Commission is currently precluded from mandating that cable channels be made available for leased access. Federal Communications Comm'n v. Midwest Video Corp., 440 U.S. 689, 709 (1979) (FCC may not regulate cable systems as common carriers). In 1983, a bill was introduced in the Senate to limit local regulatory and franchising authority. *See S. 66, "The Cable Telecommunications Act of 1983"*, 98th Cong., 1st Sess., 129 CONG. REC. 58,308-09 (1983). According to the sponsors of this proposed legislation, it would:

(1) establish a national policy concerning cable telecommunications and to encourage a competitive environment for the growth and development of cable tele-

D. Summary

Confidence in the free market as an efficient allocation mechanism relies upon the assumptions that (1) information can be efficiently distributed to agents; (2) agents have incentives to act in their best interests; and (3) all parties affected by a transaction can influence it. Applied to political units, these principles require that if the unit (1) is able to identify expertise efficiently; (2) has incentives to act in the best interest of its constituents; and (3) designs its decisions to avoid adverse effects on non-constituents, then federal intervention in transactions undertaken or controlled by those local political units is not justified. However, these assumptions may fail when applied to either consumers or political units. Therefore, although a presumption in favor of non-intervention may be proper, the failure of these assumptions to operate in a specific case may warrant some form of "higher order," specifically federal intervention for certain classes of local government action. This intervention can take the form of a subsidized information provision, specific restrictions, regulation, or antitrust liability. An examination of the case law will demonstrate how antitrust liability has been imposed.[82]

III. Evaluating The "State Action" Antitrust Case Law

This section will examine the principal cases which have defined the case law for restricting the independent activity of state or local governments. The analysis will test the usefulness of the three economic criteria by evaluating the major state action cases to determine if this economic analysis would yield a result which differs from the Court's.

A. *Parker v. Brown*[83]

Appellee was a producer and packer of raisins in California.[84] In this case the legislature of California passed an act establishing pro-

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communications; (2) establish guidelines for the exercise of Federal, State, and local regulatory authority; and (3) allow cable systems to compete in the marketplace on an equal basis with other providers of telecommunications services to the public. *Id.* at 5326 (daily ed. Jan. 26, 1983). Policy considerations of the sort discussed above have not been applied in the debate on this legislation.

82. Regulation is applied to offset anti-competitive conditions. *See infra* note 149 for a discussion of utilities regulation.

83. 317 U.S. 341 (1943).

84. *Id.* at 344.

grams for the marketing of state-produced agricultural commodities.[85] Specifically, the California Agricultural Prorate Act[86] authorized the creation of a state-selected "program committee" to prorate sales among crop producers, making sales outside the prorated limits illegal.[87] The Court noted further that the effect of this Act was to restrain competition and to maintain agricultural prices.[88] According to the Court, the region of California affected by the Act's limitations supplied "almost all the raisins consumed in the United States . . . ."[89]

The Court held that the program was not a violation of the Sherman Antitrust Act[90] since unlike "a contract, combination or conspiracy of private persons,"[91] it "derived its authority and its efficacy from the legislative command of the state."[92] If we assume that raisins constitute a relevant product market, then the effect of the state action was to allow California raisin growers to extract monopoly profits by raising the price of raisins. The effect of this was an exertion of market power, almost certainly against non-California residents. Using the economic grounds set out above,[93] therefore, this case was decided incorrectly.[94]

B. *Goldfarb v. Virginia State Bar*[95]

In *Goldfarb*, home buyers in Fairfax County, Virginia brought a class action suit against the State and County Bar, claiming that a minimum fee schedule for searching titles constituted illegal price-fixing.[96] The Supreme Court agreed that the minimum title search fee was a price fix. Unlike the program in *Parker*,[97] however, this fee-

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85. See *supra* notes 64-66 and accompanying text for an additional discussion of the facts.

86. Act of June 5, 1983, ch. 754, Statutes of California of 1933, as amended by chs. 471 & 473, statutes of 1935; ch. 6, Extra Session, 1938; chs. 363, 548 & 894, statutes of 1939; and chs. 603, 1150 & 1186, statutes of 1941.

87. 317 U.S. at 346-47.

88. *Id.* at 346.

89. *Id.* at 345.

90. 15 U.S.C. §§ 1-7 (1976 & Supp. VI 1983).

91. 317 U.S. at 350.

92. *Id. See generally*, Comment, *The State Action Exemption in Antitrust: From* Parker v. Brown *to* Cantor v. Detroit Edison Co., 1977 DUKE L.J. 871 (1977).

93. See *supra* notes 67-77 and accompanying text for a discussion of externalities.

94. The District Court in *Parker* held that the Act was illegal, specifically noting its interstate economic consequences. 39 F. Supp. 895, 901-02 (S.D. Cal. 1941).

95. 421 U.S. 773 (1975).

96. *Id.* at 778.

97. *See supra* notes 83-94 and accompanying text.

setting was found illegal because it was not "compelled by direction of the State acting as a sovereign."[98] The most favorable interpretation of this decision, in light of this Article's economic framework, is that the Supreme Court found that proper procedures were not followed when arriving at a potentially anticompetitive result. This articulation seems to be a reasonable approach to practical implementation of the "procedural integrity" criterion.[99]

This manner of implementation, which judges the "sufficiency" of active control by the state and characterizes this and cases to follow, raises an important consideration. When violations of procedural integrity involve private corruption of the political process, it would be appropriate to place liability on the corrupt individuals and not on the political entity as a whole. However, in *Goldfarb* there is no apparent private corruption; rather, the judiciary decided that the legislative and executive procedures that were followed were not sufficient to justify the anticompetitive outcome. Therefore, assigning antitrust liability to cities in cases where "procedural integrity" is violated with apparently anticompetitive effect could be proper, even while the officials acted in accordance with the deficient procedures.[100]

C. *Cantor v. Detroit Edison*[101]

In *Cantor*, a retailer who sold light bulbs challenged Detroit Edison's program of giving away free light bulbs as an illegal tie-in of bulbs to electricity and therefore an attempted monopoly.[102] This practice was found invalid by the Supreme Court, largely on the grounds that the program was instituted at the initiative of a private utility rather than a state body.[103] The mere existence of implicit

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98. 421 U.S. at 791. *See generally*, Note, *State Action And the Sherman Antitrust Act: Should the Antitrust Laws be Given a Presumptive Effect?* 14 CONN. L. REV. 135 (1981) [hereinafter cited as STATE ACTION]; Note, Parker v. Brown *Revisited: The State Action Doctrine after* Goldfarb, Cantor, *and* Bates, 77 COLUM. L. REV. 898 (1977) [hereinafter cited as Parker v. Brown *Revisited*].

99. *See supra* notes 50-60 and accompanying text.

100. An interesting alternative is the Athenian "graphe paranomon," in which a legislator making an illegal proposal to the legislature could be criminally tried even if the legislature had passed the proposal. *See* ELSTER, ULYSSES AND THE SIRENS: STUDIES IN RATIONALITY AND IRRATIONALITY 89 (1979).

101. 428 U.S. 579 (1976).

102. *Id.* at 581.

103. *Id.* at 591-92 (*Parker* not controlling because defendant is private utility). The case was remanded for determination of "whether the complaint alleged a violation of the antitrust laws . . . ." *Id.* at 603.

regulatory approval[104] was insufficient to exempt the utility from antitrust liability.[105]

The Court's requirement that antitrust liability not be imposed for "actions taken" pursuant to "express legislative command"[106] can be interpreted as refining the "procedural integrity" standard as originally set out in *Goldfarb*. However, it is not clear why regulatory approval is insufficient to ensure that "procedural integrity" is satisfied, absent a specific showing of deficient regulatory procedures or official violations. Detroit Edison's program seems inefficient, and some economic theory suggests that regulatory agencies have a tendency to act in the interests of those they regulate.[107] On the other hand, it is not obvious that Detroit Edison profited monopolistically from its practice.[108] Apparently the light bulb giveaway was largely for advertising and public relations purposes. We then enter something of a gray area, because the welfare analysis of shifts in demand resulting from such promotion can be ambiguous.[109] It is conceivable that when the totality of the circumstances described above is considered, regulatory agency approval should be a sufficient defense.

D. *Bates v. State Bar of Arizona*[110]

Two attorneys in Arizona claimed that a ban by the Arizona Supreme Court[111] on advertising by lawyers limited competition and violated their first amendment rights.[112] The Sherman Act challenge was denied by the Supreme Court because the state policy was "clearly and affirmatively expressed" and was actively supervised by the Arizona Supreme Court.[113] This case illustrates some of the con-

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104. *Id.* at 583.

105. *Id.* at 598. *See also*, Werden & Balmer, *Conflicts Between State Law and the Sherman Act*, 44 U. PITT. L. REV. 1, 9 (1982); STATE ACTION, *supra* note 98, at 144-49 for a discussion of *Cantor*.

106. 428 U.S. at 589.

107. *See*, Stigler, *The Theory of Economic Regulation*, 2 BELL J. ECON. 3 (1971).

108. Conceivably, if the regulated rate of return is excessive, there may be gains from expanding the rate base associated with giving away light bulbs.

109. *See* Fisher & McGowan, *Advertising and Welfare: Comment* 10 BELL J. ECON. 726 (1979); Dixit & Norman, *Advertising and Welfare: Reply*, 10 BELL J. ECON. 728 (1979).

110. 433 U.S. 350 (1977).

111. 17A ARIZ. REV. STAT. ANN. S. CT. RULE 29(a) (1973) (adopting code of Professional Responsibility of American Bar Association, except D.R.2-105(A)(4) and D.R.6-101(A)(1)).

112. *Id.* at 356.

113. *Id.* at 362.

ceptual problems posed by *Cantor*. Continuing the "procedural integrity" analysis, it would be argued that state supreme courts are "reasonable" regulators. It is not apparent, however, that state supreme courts regulate more in the public interest than did the regulatory agency in *Cantor*. On the assumption that there was no statute[114] prohibiting lawyer advertising in Arizona, it is not easy to reconcile the *Cantor* and *Bates* decisions. There may be an argument that the regulatory agency in *Cantor* did not "clearly and affirmatively express" the desirability of free light bulbs, only passively accepting Detroit Edison's tariff proposals. It would be simpler to conclude, however, that the Supreme Court generally frowns on promotional giveaways or advertising.

E. *City of Lafayette v. Louisiana Power and Light*[115]

In this case, several cities, including Lafayette, owned and operated electric utilities within their limits. They sued Louisiana Power and Light, a privately owned utility, claiming attempts to restrain trade by boycotts, refusals to sell power, and engaging in sham litigation.[116] Louisiana Power and Light filed a counterclaim, alleging a conspiracy of the municipalities to engage in sham litigation, foreclose competition through long-term supply agreements, and tie the provision of electricity to purchases of water and gas service.[117] The cities argued that the "state action" doctrine rendered them immune.

Lafayette was the first case in which the Court refused to extend the state action immunity of *Parker* to municipalities. The Court affirmed the relevant appellate court opinion, which found that city actions are immune only if they are taken pursuant to a state policy meeting the *Goldfarb* standard.[118] The constitutional "sovereignty" of the state does not extend to its cities.[119] The Court specifically noted that neutral courts existed to ensure that competition would ensue "without regard to the amount of influence [any enterprise] might have with local or state legislatures."[120]

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114. *But see supra* note 111 (an Arizona Supreme Court rule was involved in the case).

115. 435 U.S. 389 (1978). See generally *State Action*, *supra* note 106, at 151-54 for a discussion of *Lafayette*.

116. *Id.* at 392 n.5.

117. *Id.* at 392 n.6.

118. 435 U.S. 394 (citing 532 F.2d 534-35).

119. *Id.* at 412. *See also* Werden & Balmer, *supra* note 105, at 12.

120. 435 U.S. at 407. It is noteworthy that the Court cited the large number of local government units in the United States (62,437) in refusing to extend antitrust

The *Lafayette* decision relied upon two important claims. First, the court imposed a requirement that the state must be actively involved in a city's actions.[121] This requirement is not justified by economic theory.[122] The economic analysis of government actions makes no distinction between states and cities. If a city's action reflects available information, is procedurally adequate with respect to its residents, and reflects no market power, then the action should be allowed. Hence, regardless of the empirical merits of the *Lafayette* decision, the argument that state policy is even relevant to the appraisal of a city's decision is unsound.

The second claim made in *Lafayette* is that legislative procedure itself may not be sufficient to permit exceptions to the antitrust laws.[123] This says, in effect, that no collective decision through the political process can excuse anticompetitive conduct. Moreover, one wonders what constitutes a "clear and articulate expression" by the state if state statutes do not fulfill the standard. Subsequent case law does not seem to have retained this extreme position.[124] It might be claimed that only city "legislatures" would enact laws subverting the competitive process. The performance of state legislatures and Congress lends little support to this argument.

F. *California Retail Liquor Dealers Assn. v. Midcal Aluminum, Inc.*[125]

Midcal Aluminum challenged a California law authorizing a uniform wholesale price maintenance scheme for wine.[126] The Court found that this statute unreasonably restrained trade by mandating,

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immunity. *Id.* at 407-08 (citing U.S. Bureau of the Census). This seems counter to the general principle that competition is aided, and collusive conduct deterred, by large numbers of economic actors. *See* SCHERER, *supra* note 54, at 199-200.

121. 435 U.S. at 413 ("*Parker* doctrine exempts only anticompetitive conduct engaged in as an act of government by the State as sovereign, or, by its subdivisions, pursuant to state policy to displace competition with regulation or monopoly public service"). *Id.*

122. *See supra* notes 20-21 and accompanying text.

123. 435 U.S. at 406 (Congress "did not leave this fundamental National policy [of competition] to the vagaries of the political process . . .").

124. *See* California Retail Liquor Dealers Ass'n v. Midcal Aluminum, 445 U.S. 97 (1980) (Court found statutory expression clear and articulate, but held contested conduct illegal because not actively supervised by state). *See also supra* notes 121-23 and accompanying text (arguing against the second *Lafayette* claim).

125. 445 U.S. 97 (1980).

126. CAL. BUS. & PROF. CODE § 24862 (West Supp. 1979) (repealed 1980 CAL. STATS. ch. 1368, § 5).

but not supervising, the resale price maintenance program.[127] Although the policy was clearly and affirmatively articulated in a statute that met the *Bates* and *Cantor* tests,[128] the Court formally incorporated the requirement that the state "actively supervise" the anticompetive conduct.[129] Such supervision was judged not forthcoming in *Midcal*.[130]

One could optimistically conclude that the Court was simply refining the "procedural integrity" criterion on the basis of general expectations as to its propriety. However, one can also conclude that the criterion is being "refined" on an *ad hoc* basis to fit the Court's beliefs about the efficiency of a specific practice. "Procedural integrity" criteria should be tested by the kinds of practices they permit. Since city intervention in a market may serve to compensate for economic effects outside that market, however, an independent efficiency test has serious weaknesses when used to assess city actions.[131] The *Midcal* decision leaves the impression that the Court was really using such a test, albeit camouflaged by procedural criteria like "clear expression" and "active supervision."

G. *Community Communications Co. v. City of Boulder*[132]

This case started the recent flurry of activity on municipal antitrust liability. Boulder imposed a moratorium on expansion by its cable system to give itself additional time to prepare new cable legislation. In response, the cable system sued Boulder, claiming this restriction would violate section one of the Sherman Act.[133] As a defense, Boulder

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127. 445 U.S. at 102.

128. *See supra* notes 110-14 (*Bates*) & 109-17 (*Cantor*) and accompanying text.

129. 445 U.S. at 105 (citing *Lafayette*, 435 U.S. 389, 410 (1978)). *See also supra* notes 115-24 and accompanying text (*Lafayette*).

130. 445 U.S. at 105-06.

131. *See* text preceding note 48.

132. 455 U.S. 40 (1982).

133. 15 U.S.C. § 1 (1976 & Supp. VI 1983).

> 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. Every person who shall make any contract or engage in any combination or conspiracy hereby declared to be illegal shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not exceeding one million dollars if a corporation, or, if any other person, one hundred thousand dollars or by imprisonment not exceeding three years, or by both said punishments, in the discretion of the court.

Id.

defense, Boulder claimed that cities inherited the state authority of *Parker* through "home rule" statutes. The Court abrogated this defense.[134] The city's action must meet the *Midcal* tests of clear and affirmative articulation and active supervision by the state.[135] Since Colorado had no specific policy regarding cable television, Boulder lost the case.[136] The *Boulder* decision, which adds nothing to the "procedural integrity" interpretation, reaffirms the unjustified necessity for state involvement in city affairs.[137]

H. Synthesis

The "economies of expertise" criterion[138] does not significantly influence the outcome in these cases. Rather, most of the case law could be interpreted as delineating the procedural requirements[139] for instituting seemingly anticompetitive conduct. Specifically, these procedural requirements refer to the judicial mandate stating that immunity is available only for actions that have been clearly articulated and affirmatively expressed, as well as actively and exclusively supervised by the State.[140] Some of these decisions, however, imply that the Court's evolution of these requirements has been more a function of views on the factual effects in the specific instances rather than an appeal to a theory of procedural integrity. In *Cantor*, the Court noted that light bulbs were not a necessary facet of electric utility regulation.[141] In *Midcal*, the Court emphasized the apparent illegality of the wholesale price maintenance scheme.[142] These decisions suggest that the evolution of the case law has been guided not only by a theory of

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134. 455 U.S. at 53.
135. *Id.* at 52.
136. *Id.* at 55.
137. It may be argued that the Court's insistence on state supervision may be an application of a particular view of "procedural integrity." Except where a city's action affects others within the state, however, this interpretation of "procedural integrity" would be unsound. Under the analytical framework employed here, that criterion is designed specifically for the evaluation of a government's actions affecting only its constituents. If a state feels that its interests are being harmed by the actions of one of its cities, however, it can remedy the matter by either passing its own laws restricting city actions or by bringing an action against the city.
138. *See supra* notes 22-26 and accompanying text.
139. See *supra* notes 27-35 and accompanying text for a discussion of the theory and importance of procedural integrity.
140. *See supra* notes 95-113, 126-31 and accompanying text.
141. 428 U.S. 579, 598 (1976).
142. 445 U.S. 97, 102 (1980).

proper procedural considerations, but also by the nature of specific fact situations confronted by the Court.

The third criterion, the exercise of market power against non-constitutents, generally was not considered. This is understandable since, in all of these cases but *Parker*, there were no substantial exercises of market power outside the local government's jurisdiction. In *Parker*, however, where the effects on non-constituents were paramount and recognized by both circuit and state supreme courts,[143] the Supreme Court decided incorrectly by ignoring the effects of these externalities.[144] In addition, the *Lafayette* and *Boulder* decisions imposed a requirement of state involvement in city decisions[145] which is unjustified by economic policy considerations unless the city actions result in the exercise of market power against those residing outside the city. [146]

IV. Policy And Implications

A. Economies of Expertise

Under this rationale, the federal government may be better able to make economic choices which benefit the city residents' interests than the local government. This ability would result from economies of both scale and expertise in making certain types of decisions. Specifically, it may be less costly for the federal government to make decisions for a number of cities, either at one uniform time or repeatedly, than it would be for each city to acquire the expertise necessary to render an optimal decision.[147]

The "economies of expertise" policy distinguishes between cities that realize their expertise limitations and those which do not. The optimal policy concerning the former would be to direct the federal government to supply the necessary information to the cities at marginal cost.[148] Since the essence of the city's failure to allocate effi-

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143. *See supra* note 94 and accompanying text.

144. *See supra* notes 93-94 and accompanying text. Also, if the wholesale price maintenance scheme in *Midcal* applied to out-of-state retailers, external effects could pose a problem if California wineries possess economic power in a relevant wine market.

145. *See supra* notes 115-24 (*Lafayette*), 132-37 (*Boulder*) and accompanying text.

146. *See supra* notes 61-63 and accompanying text.

147. See *supra* notes 22-26 for a discussion of economies of expertise.

148. A complete cost-benefit calculation would include the welfare effects of the taxes needed to support this program. *See* Samuelson *supra* note 57 at 429 (marginal cost at any production level is the extra cost of producing one extra unit more (or less)).

ciently is the high cost it faces for procuring necessary economic information on its own, it would be preferable to give the city the required information rather than hold it liable under the antitrust laws for not using it in the formation of its policy.

Applying the economies of expertise policy to a city which is unaware of its ignorance is more difficult because the local entity must either be convinced of its need for the expert information or forced to accept it. Legitimate government action concerning these cities should be limited to advertising that the needed expert information is easily available. In cases where paternalistic intervention can be justified, specific legislative prohibitions may be reasonable, although they can easily induce the inefficiency that inevitably follows from statutory restriction of consumer choice.[149] Except for making expertise on competitive effects available at no or low cost, as in the antitrust "business review" procedure, [150] no other policies, including antitrust liability, are likely to be efficient or workable.[151] Making determinations that the city properly utilized the available information, however, is likely to be highly problematic. Antitrust liabilty could be utilized as an incentive to use available information.

The "economies of expertise" analysis, although theoretically sound, does not appear to have played a significant role in the legal development of municipal antitrust liability. While no strong affirmative action seems economically warranted, it would be advantageous for the federal government to provide, upon the local government's recognition of its information need and its subsequent request, an assessment of an actual or prospective local government action's effect on competition.[152] Unless the demand for such assessments becomes

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149. These inefficiencies are recognized and government regulation is applied to regulate prices and profits. Rate-regulated public utilities are an illustration of this response. BREYER, *supra* note 69, at 15-16.

150. *See* 28 C.F.R. ¶ 50.6 (1983) (Antitrust Division business review procedure). The Department of Justice is not authorized to give advisory opinions to private parties, but the Antitrust Division, in certain circumstances, has reviewed proposed business conduct and stated its enforcement intentions. *Id.*

151. For example, the policy of imposing malpractice liability is potentially a way to ensure that doctors obtain and use information needed to make reasonable decisions regarding medical care. However, this may not be an efficient or practical way to control whether consumers are served by unlicensed doctors or given unlicensed drugs. This analogy also illustrates the practical problems in determining whether information was properly employed.

152. The Department of Justice and Federal Trade Commission are sources of the relevant expertise.

expensive, this information should be freely available to encourage the consideration of the competitive consequences of public actions. Such a policy would be consistent with the current Antitrust Division policy of filing advisory comments on the competitive effects of actions being considered by regulatory agencies.[153]

B. Procedural Integrity

This rationale justifies federal intervention in city or state actions if those actions were not undertaken in accord with proper procedural principles of democratic government.[154] There are two important general cases, with the significant variable being whether the city or state action was the result of officials acting within or outside of their legal authority.

The standard example of a potentially anticompetitive[155] action taken by officials acting outside their legal authority would be a city official who utilized his ability to control entry into markets through franchising or zoning for personal gain. The primary damage in this case results from the corrupt behavior of the officials in question. For this reason, liablilty enforced through anti-corruption or anti-bribery laws would probably be more efficient, particularly when compared to the less direct and more problematic use of the antitrust laws. For example, the corrupt official himself may not be a competitor in the relevant market.[156] When the issue is essentially corruption, society is improperly served by invoking the antitrust laws with their specific focus on the remedies of competition and performance in the marketplace.[157] However, the city probably should not be liable under the antitrust laws for actions independently taken by its officers unless it was ultimately responsible, for example, by not sufficiently policing its officials' conduct.

A more difficult case arises when the city's actions are taken within the authority granted to its officials. To find municipal antitrust

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153. *See* Baxter, *supra* note 40, at 700.

154. See *supra* notes 27-35 and accompanying text for a discussion of the procedural integrity theory.

155. If the action were not potentially anticompetitive, it would not raise antitrust concerns regardless of fidelity to proper procedures.

156. *See* Merger Guidelines of Department of Justice, 1 TRADE REG. REP. (CCH) ¶ 4502.10 (1982) for a discussion of market definition.

157. *See* text following *supra* note 99 & 155, stating that other laws are better suited for addressing these problems.

liability in this case requires that the authority structure of the city, such as the decision procedures, be found improper. This again raises the complexities inherent in the procedural integrity rationale.[158] Efficiency standards are of questionable operational value in evaluating local government procedures. A better alternative would be to examine the procedural standards themselves—to determine, for example, whether the issue received a fair hearing, whether it was publicized, and whether a significant institutional hurdle such as legislative enactment had to be met.[159] The appropriate standards are not easy to determine.[160] In addition, a particular type of "levels problem" may exist. If the immediate procedures appear inappropriate but are in accord with a constitution or charter that was enacted using "proper" procedures, to which governmental level should the procedural integrity evaluation standard be applied? Does the propriety of the constitution inure to the immediate action?[171] The propriety of procedures cannot be based solely on procedural grounds; appeals to other, more fundamental criteria beyond the scope of this Article inevitably must be applied to settle these sorts of questions.

These are complex philosophical and economic issues in which a gradual evolution of thought is more likely to provide a reasonable approach than an instant legislative mandate. The case law could be interpreted as an effort to come to grips with this issue,[162] and because of its ongoing dialectical nature, case law is the proper forum in which to debate this issue. However, as *Lafayette* and *Boulder* demonstrate, the law treats cities differently from states, requiring active state supervision of city actions.[163] This distinction is unwarranted on economic grounds. Cities should be treated in the same manner as states when their actions are judged by procedural criteria such as the degree of articulation or supervision. If a state action would be legal

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158. *See supra* notes 27-60 and accompanying text.

159. The concept of examining the process employed by a locality in instituting an erstwhile anticompetitive policy is analogous to examining the procedural due process protection accorded to government deprivations of life, liberty or property. *See* NOWAK, ROTUNDA & YOUNG, *supra* note 34, at 526-30.

160. *See* text preceding *supra* note 50.

161. Moreover, this "levels problem" itself leads to an "infinite regress" of sorts: city actions are chosen in accord with legislative rules chosen in accord with charters chosen in accord with . . . *ad infinitum*.

162. For a discussion of the procedural integrity criterion in the state action case law, see *supra* notes 95-131 and accompanying text.

163. *See supra* notes 145-46 and accompanying text.

because it was in accord with reasonable procedures, then an analogous city action should similarly be accepted without the state "chaperoning" that the case law currently requires. Cities should be immune from antitrust liability for actions by the city's officers which exceed their authority. Liability should rest with the responsible person, although assignment of ultimate responsibility among the city and its officials could become complex.

C. Externalities

The antitrust problem presented by externalities arises when a city or state has power in a relevant economic market and elects to use that power against non-constituents.[164] Unlike the "procedural integrity" issue, this problem is arguably no worse than the typical antitrust case. If a city or state takes an action equivalent to cartelization by its resident firms and such action would have market power consequences to residents outside that jurisdiction, then antitrust law is the appropriate tool.[165] First, the external effect must involve an efficiency, not simply a reallocation of commerce. For example, one steel company could not successfully sue an automobile firm under the antitrust laws for simply awarding a contract to another steel company. Likewise, a city should not be liable to suit by one cable firm if it awards its cable franchise, in accord with proper procedures, to another.

Second, as a pragmatic matter, states are more likely to exert market power than cities by virtue of their greater geographic breadth and coverage of more competitors. This is not to say that cities may never be relevant areas for assessing market power in this context. For example, collusion among the docks in a port city could exert monopoly power against consumers or firms over a wide area. In addition, many cities, particularly large ones, may have enough of the firms in the relevant market[166] within their jurisdiction to be able to exert market power against non-residents. For the pragmatic reasons dis-

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164. Use of that power against its own constituents is a question of whether the city is acting in accord with its residents' interests. This question falls under the first two headings of expertise economies and procedural integrity.

165. *See* text following *infra* note 179. *See also supra* notes 48-53 and accompanying text.

166. See Merger Guidelines of Department of Justice, 1 TRADE REG. REP. (CCH) ¶ 4502.30 (1982) for a definition of "relevant geographic market" in the antitrust context.

cussed above, however, concerns regarding anticompetitive externalities are more likely to be serious in cases involving states rather than in those involving counties or cities.[167]

The "externality" issue has been ignored by the courts. The seminal state action case in this area, *Parker*, was decided incorrectly when judged on economic grounds because it ignored the external effects of the state action.[168] As some commentators have suggested, a decision effectively reversing *Parker* would be appropriate, either through legislation or judicial decision.[169] Thus, besides the procedural standards implied in the case law, which should be equally applied to cities and states, the issue of using market power against non-residents must be included in evaluating state or local actions.

V. Conclusion

This Article has utilized economic analysis rationale for decentralized decision-making to assess the antitrust liability of local government actions. Three criteria, economies of expertise, integrity of public decision-making procedures, and external harms to non-constituents provide an analytical framework. The major state action and municipal antitrust case law represents an evolution of standards emphasizing procedural integrity. External effects, however, have been misjudged. In *Parker* their existence was ignored, while in *Lafayette* and *Boulder* cities were held liable absent a showing that market power was exerted against non-residents as a result of the challenged actions.

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167. If the inefficient external effects result not from market power but from market failure, federal involvement also may be appropriate. For example, air pollution crossing state lines would fit into this category. This kind of situation, however, does not seem to raise antitrust concerns.

168. *See supra* notes 64-67, 93-94 and accompanying text.

169. *See* Werden & Balmer, *supra* note 105, at 69-72. These authors examine intent, rather than procedural integrity or externalities, to determine the validity of state statutes. *Id.* at 64. Without commenting on the legality of this approach, it seems ill-advised on economic grounds. As argued above, the normative basis for economic efficiency is grounded in part on the autonomy of the decision-maker who reaps the burdens and bears the costs of its actions. *See supra* note 16 and accompanying text. If a community elects, for whatever reason, to create monopoly power against itself, this decision should be implemented unless ignorance, procedural abuse or external effect can be shown.

170. See *supra* notes 147-69 and accompanying text for discussion of recommended policies.

be implemented to enable the federal government to provide expert information at marginal cost to officials contemplating potential or actual local governmental activity. In addition, anticipatory consideration of the competitive consequences of public actions should be encouraged. The flexible and evolutionary approach to procedural integrity found in the state action case law should be maintained. In addition, procedural criteria distinctions between state level and city level actions should be eliminated. Finally, the exercise of market power by a local government against non-constituents should be grounds for antitrust liability.